The Society of Pension Professionals (SPP) response to the DWP & HM Treasury consultation, *“Pensions Investment Review: Unlocking the UK pensions market for growth”*

1. Introduction

1.1. Investments made by UK pension funds already play a vital role in supporting economic growth and are a major source of long-term investment in the UK economy.

1.2. As the Chancellor, the Rt. Hon. Rachel Reeves MP, noted last year, pension schemes already invest one trillion pounds in the UK economy[1]. This is in a diverse range of assets including renewable energy, healthcare, transport, utilities and education.

1.3. More than half of UK pension funds invest in people and planet – with social and affordable housing being the most popular social impact investments for these investors[2].

1.4. UK pension funds play a vital role in the success of the country; the industry broadly agrees it can still do more and is very much committed to doing so, as evidenced by the generally positive manner in which most of the industry has reacted to Government announcements on the need for an increased commitment to productive finance.

1.5. The Society of Pension Professionals (SPP) is committed to working with the Government to maximise the chances of success in securing its policy objectives.

1.6. We are concerned that some of the current proposals are likely to have unintended consequences for scheme members, whose interests we believe should be at the heart of any pension policy reforms i.e. imposing a large minimum scale of AUM irrespective of whether or not this is in members’ interests. This is starkly evidenced by the fact that in recent years most of the UK master trusts and GPPs with the best investment returns have been well below the £25bn AUM threshold the Government is now proposing.[3]

1.7. We welcome the confirmation provided by HM Treasury in December 2024 that the exclusion of single employer schemes from the proposed reforms also applies to multi-employer schemes where the employers are all part of the same group. In the remainder of this response references to single employer schemes should be read as including such group schemes, and references to multi-employer schemes should not.

1.8. We also believe there are a number of alternative solutions that would deliver the Government’s policy objectives more effectively, and we have explained these below.

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[1] **Chancellor vows 'big bang on growth' to boost investment and savings, July 2024: https://www.gov.uk/government/news/chancellor-vows-big-bang-on-growth-to-boost-investment-and-savings**

[2] **Better Society Capital, March 2022: https://bettersocietycapital.com/latest/more-than-half-of-uk-pension-funds-investing-in-people-and-planet/**

[3] **See particularly Figure 11 in Chapter 4 of Pension fund investment and the UK economy, 27 November 2024: https://www.gov.uk/government/publications/pension-fund-investment-and-the-uk-economy/pension-fund-investment-and-the-uk-economy**

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1.9. One key issue which needs very careful consideration is the order in which all the various proposed legislative and regulatory pension reforms are rolled out. The changes proposed by this current consultation alone could have a fundamental impact on the pensions market and lead to extensive closure of offerings as schemes and funds are driven to merger. If those same schemes are also required to integrate decumulation offerings, track and report on VFM and transfer out to other, higher-rated for VFM, providers, there is considerable risk of wasted costs, and potentially serial transfers as receiving schemes are themselves pushed to wind up and merge. We would urge Government to work through the optimal order of events to avoid duplication of cost and multiple serial transfers.

1.10. In short, the SPP wishes to help policymakers make effective, evidence-based policy that will likely stand the test of time and deliver for savers as well as the country.

2. Executive summary

2.1. **It is unclear if a minimum pension fund scale of £25bn AUM is needed or that scale alone will drive any substantial additional investment diversification.** Similarly, there is no compelling evidence that scale alone will result in those managing works-based pension schemes to increase investment in UK productive assets, let alone deliver better saver returns.

2.2. **If a minimum AUM threshold is to be imposed, the Government should consider a much smaller AUM size metric, we suggest £5bn would be appropriate, with an agreed glide path to larger scale over a longer timeframe.** In addition, the Government may wish to consider introducing industry league tables, constructed using a concise set of metrics that holistically assess member outcomes and are calculated by an independent trusted source. This would incentivise providers to aim for the size of AUM that would be most conducive to allocating investments with the most attractive net of fee risk-adjusted returns.

2.3. **With regard to exemptions, if the Government decides to proceed with a minimum AUM requirement then it should consider a broad exemption for smaller funds that outperform their larger peers; an exempt growth period during which time any new arrangements can focus on building scale; and exemptions for schemes that serve niche markets such as Sharia compliant default arrangements and CDC schemes.**

2.4. **The SPP supports the introduction of a contractual override to allow without consent bulk transfers for contract-based arrangements where this is appropriate. For IGC's to assess and approve contractual overrides and bulk transfers, the COBS rules and guidance must be updated.** If there is to be a fiduciary (or fiduciary-like) duty, then the FCA should reconsider whether indemnification of IGCs (or GAAs) by providers should be mandatory.

2.5. **In relation to contractual override without consent for contract-based arrangements, where the provider fails to follow the correct process or fails to undertake their role to the expected standard, and the consumer is able to demonstrate a direct financial loss, compensation or a right to legal recourse should follow but this should be no more or less than currently applies to members of trust based schemes where there is a breach of trust.** The rules will need to be designed in such a way as to minimise ambiguity about whether the provider did what was required. This is because too much ambiguity will probably mean schemes will be reluctant to do this, even if they are acting in good faith with appropriate due diligence.

2.6. **SPP members hold mixed views as to whether a duty on sponsoring employers to have a named executive with responsibility for retirement outcomes or placing a duty on employers to consider value, should be introduced.** However, there is consensus that if such a duty is introduced, then to limit costs and disruption, it should only apply to larger companies i.e. those with 250+ employees.

2.7. **If Government proceeds with all or any of the proposals in this consultation, the sequencing in which these and other proposals are rolled out will make a very significant impact on overall costs and member experience.** The SPP therefore urges policy teams to work through the optimal order of events to avoid duplication of cost and multiple serial transfers and to provide industry with a clear timetable of such sequencing.

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3. Consultation response

Chapter 2 – Achieving scale in the Defined Contribution market

3.1. **Question 1: Do you think that providers should be restricted to a limited number of default funds, and if not why? Please consider any equality considerations, conditions and to what extent saver choice could be impacted.**

3.2. The consultation paper proposes two separate but cumulative thresholds: a maximum number of "defaults" and a minimum size of "defaults", but explores whether the "default" in question should be default arrangements or default arrangements. We have responded to Question 1 below on the assumption that it only relates to default arrangements. We have looked at the two proposals separately, and then cumulatively.

3.3. It is important that there is clarity regarding the definition of a default arrangement. We see a default arrangement as an investment strategy that members savings are invested in throughout their membership of a scheme. Default arrangements can comprise underlying fund components and often involve lifestyling or derisking as a member ages. We have assumed that any minimum AUM or maximum number of defaults applies to the assets invested in the strategy as a whole and not the underlying component funds. In addition, where Target Date Funds (TDFs) are used, we recommend that a "family" of TDFs is considered as one default arrangement for this purpose.

Minimum size of default arrangements

3.4. The focus here is on achieving fewer, but very much larger, default arrangements across the wider market. That in turn should, following the premise of the consultation paper, give greater scope for diversification and investment in productive finance, UK or otherwise.

3.5. It is important to recognise that scale alone does not achieve diversification, although it can increase options like direct holdings in major infrastructure.

3.6. Furthermore, there does not appear to be any compelling evidence that scale alone will result in increased investment in UK productive assets nor deliver better saver returns. Indeed, paragraph 70 of the Government's evidence accompanying the consultation document states, *"The evidence linking pension provider scale and gross investment returns is mixed"* before paragraph 71 adds, *"International evidence also seems inconclusive on the benefits of scale on gross investment returns."* Figure 11 in that evidence starkly illustrates that in recent years most of the UK master trusts and GPPs with a default arrangement producing the best investment returns have been well below the £25bn AUM threshold the Government is now proposing.[4]

3.7. To further emphasise the apparent weakness in any assertion that better saver returns will be delivered through these reforms, it is worth noting "evidence" from the Government Actuary's Department. Their analysis was published with a Government press release title, "GAD's analysis supports government's pension reforms" yet paragraph 64 of that same report concludes, "O*verall, the analysis highlights: An asset allocation with a greater level of exposure to private markets **may** deliver **slightly** greater returns to members (up to 2% greater pension pot compared to a baseline scenario). **However, there is considerable uncertainty**, particularly around the extent future performance will differ compared to past performance."* This can hardly be considered an endorsement of these proposals, or a robust evidence base upon which to base policy.

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[4] See particularly Figure 11 in Chapter 4 of Pension fund investment and the UK economy, 27 November 2024: https://www.gov.uk/government/publications/pension-fund-investment-and-the-uk-economy/pension-fund-investment-and-the-uk-economy

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3.8. Likewise, the Government analysis accompanying this consultation[5] contains numerous concerning admissions. For example, paragraph 62 states, "*UK-focussed strategies would be expected to underperform the Baseline and result in smaller pot sizes were recent past market conditions to persist."*

3.9. Paragraph 64 adds, *"…there is considerable uncertainty, particularly around the extent future performance will differ compared to past performance."*

3.10. So, the available evidence does not indicate that scale itself delivers good returns, indeed there are some examples of very large funds that provide comparatively poor returns, with several smaller funds outperforming their larger peers. The absence of any hard evidence to support these proposals appears to be in stark contrast with previously stated desires to deliver evidence-based policy changes and so we recommend further analysis is undertaken if a minimum AUM requirement is to be introduced.

3.11. Based on the available evidence, if a minimum AUM threshold is to be imposed, it should start much lower, for example £5bn, with a glidepath to greater scale over a longer timeframe, perhaps a decade or two. There should also be clear exceptions and pathways for new entrants.

Maximum number of default arrangements

3.12. The main thrust of this proposal is that multi-employer DC schemes used for AE should be invested in far fewer default arrangements because having many default arrangements on offer reduces the potential for meaningful investment in productive finance.

3.13. To deliver optimal outcomes, a default arrangement needs to cater for the different needs and circumstances of different member cohorts. That may well involve the use of several default arrangements to deliver the appropriate balance of risk and reward for each group. This is a good example of where the need for multiple default offerings may be stymied by minimum size thresholds or limits on the number of defaults to offer. This may be an area where either specific exemptions are appropriate, or a degree of flexibility is needed.

3.14. For example, needs and circumstances may differ hugely as between a small retailer on the one hand, and a professional services firm or investment bank on the other. A greater level of risk might be appropriate with large individual pots or for higher earners. Subjecting providers to a maximum number requirement would seem to risk a dumbing-down of default arrangements, with bespoke arrangements disappearing and providers shifting to a "one size fits all" model. If providers are forced to cut the number of default arrangements offered, the cuts may well fall most easily upon niche funds designed to provide exposure to illiquid assets and other alternative asset classes.

3.15. Concerns as to equality and ESG issues also arise. At least one major provider already offers a Sharia compliant default arrangement and underlying default arrangements, aimed at meeting the needs of Muslim employers and the UK's 3.9m Muslim population. And, as things stand, an employer whose employees are likely to have particular views on ESG issues (e.g. an environmental charity) may work with consultants to devise a bespoke default arrangement which reflects relevant values and beliefs – for example, using default arrangements which have a "climate tilt". Arrangements such as these may well be jeopardised by a maximum number requirement.

3.16. We recognise that undue proliferation of default arrangements is undesirable from a UK-wide perspective. A provider should not use multiple default arrangements unless there is a clear rationale, directed at delivering optimal outcomes for members. However, it seems to us that unnecessary or counterproductive proliferation can be addressed via the proposed new value-for-money framework. If a provider uses multiple default arrangements which add to complexity or cost but do not deliver a commensurate benefit (in terms of risk-adjusted investment returns), we expect this to be identified and addressed as part of the VFM process.

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[5] **Pension fund investment and the UK economy, DWP, November 2024:**
https://assets.publishing.service.gov.uk/media/673f3ca459aab43310b95a8d/pension-fund-investment-uk-economy.pdf

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Combining a minimum AUM requirement with a maximum limit on the number of defaults

3.17. If a "minimum size" requirement is to apply, then we see no clear logic to restricting the number of default arrangements which a provider can use as well, provided that each of the funds is of sufficient scale (whether individually or because the provider is able to benefit from scale).

3.18. One alternative if both thresholds must be used would be to make them additive rather than cumulative i.e. a provider may offer any number of default arrangements worth over the particular AUM threshold, but only a maximum number of defaults below that AUM threshold.

Timing of changes

3.19. The sequencing of the various pension policy reforms being proposed by the Government and regulators needs considerable attention. The proposals in this consultation alone could have a fundamental impact on the pensions market, leading to the closure of numerous offerings as schemes and funds are driven to merge. If those same schemes are also required to undertake work on small pot consolidation, integrate decumulation offerings, track and report on VFM and transfer out to other, higher-rated for VFM, providers, there is considerable risk of wasted resources, time and costs, and potentially serial transfers as receiving schemes are themselves pushed to wind-up and merge. We therefore urge the Government to work through the optimal order of events to avoid duplication of cost and multiple serial transfers.

3.20. **Recommendation 1: It is unclear if a minimum pension fund scale of £25bn AUM is needed or that scale alone will drive any substantial additional investment diversification. If policymakers decide to proceed with a "minimum size" requirement, then we suggest this is set at £5bn, with a glidepath to greater scale over a longer timeframe.**

3.21. **Recommendation 2: that any restriction on the number of default arrangements which a provider can use should be limited to default arrangements which do not meet any applicable minimum size requirement.**

3.22. **Recommendation 3: that the Government offers clear guidance, details of any necessary exemptions and a timetable/roadmap in relation to the necessary sequencing of various interrelated pension policy reforms.**

3.23. **Question 2: The proposed approach [i.e. the application of a "minimum size" requirement] 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?**

3.24. Again, it is unclear whether specifying a minimum size for default arrangements will drive a significant diversification of investments. Indeed, we note that the consultation document itself acknowledges the fact that, *"...there is no consensus on the optimal size of a DC pension fund."*

3.25. A default arrangement being of sufficient scale does not, in itself, mean that there will be an allocation to illiquid assets (UK-based or international) or alternative asset classes. Indeed, the largest investment products by AUM will typically be equity index-trackers with no such allocation. Both a "minimum size" requirement and a "maximum number" requirement could, as previously mentioned, actually push providers away from products with a productive investment focus.

3.26. We see some force in the argument that, other things being equal, the largest providers may be best-placed to invest in a diversified way, because they may have greater investment budgets and in-house investment resource. However, that argument goes to the scale of the provider, not the scale of default arrangements. In any case the argument only goes so far, because, as has been identified in the FCA value-for-money review, some substantial providers are currently operating on low-cost models which constrain investment budgets. The best way to change behaviours here may therefore be through the forthcoming VFM framework and/or league tables, both of which will drive the focus away from cost.

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3.27. It is not clear to us that applying a "minimum size" requirement at default level would have an impact on the pricing offered to employers, except in that the charges associated with of-scale funds may be slightly lower than those associated with sub-scale funds. However, this would not be sufficient to offset the additional charges associated with investing in illiquid and alternative asset classes.

3.28. **Question 3: What do you think is the appropriate minimum size of AUM at default arrangement level within MTs/GPPs for these schemes to achieve better outcomes for members and maximise investment opportunities in productive assets.**

3.29. It is important to emphasise that returns from DC default arrangements over recent years have on the whole been strong, particularly given the large weights to global equity, which has been one of the strongest performing asset classes. It could therefore be argued that high quality outcomes have been provided from investment portfolios. That said, we agree that allocations to private market assets, including productive assets, may potentially enhance risk-adjusted returns on a forward-looking basis.

3.30. However, we do not believe that better outcomes for members and investments in productive assets are being hampered by a lack of scale. Again, we therefore do not believe policymakers need to specify a minimum size of default arrangement AUM.

3.31. The constraint at present is largely due to the excessive focus on minimising cost versus maximising long-term value. The forthcoming Value for Money framework will help address this. A further catalyst to change this focus could be through the introduction of league tables constructed using a concise set of metrics that holistically assess member outcomes and are calculated by a trusted source. This would incentivise providers to aim for the size of AUM that would be most conducive to allocating investments with the most attractive net of fee risk-adjusted returns. An entity that is achieving poor scores in the league tables would naturally come under additional regulatory scrutiny and market pressure to determine the cause of the poor scores, which may or may not be due to a lack of scale. The SPP believes that dealing with any poor performers in this way would be a less harmful, less complex and ultimately more effective approach than trying to solve the problem through prescribing a minimum AUM.

3.32. Setting a minimum AUM could have unintended consequences given the optimal size will likely differ by provider and change over time. Again, if the Government is minded to specify a minimum, we think £25bn is far too high at this time given the current size and maturity of the UK DC market. Whilst there may be economies of scale in the provider space, there are a number of diseconomies of scale that would likely factor with such a high minimum (which would likely become worse over time given ongoing contributions, investment returns and a lack of competition would quickly cause the AUM to increase further). So, a much lower minimum AUM, for example £5bn, with a glidepath to greater scale over a longer timeframe, perhaps a decade or two, would make more sense.

3.33. **Question 4: Are any other flexibilities or conditions needed regarding the minimum size of AUM (for example, 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 circumstance)?**

3.34. In line with our response to question three above, a legislative minimum AUM level is not necessarily required to achieve the Government's objectives.

3.35. It is our view that a minimum AUM of the order being discussed presents a very clear barrier to entry and hence will stifle new entrants to the market. That concern also extends to existing smaller schemes that perform well and often deliver better saver returns than their larger counterparts. Any decision to impose a minimum AUM requirement on default arrangements (or default arrangements) in such circumstances, i.e. irrespective of whether or not doing so is in members' interests, will close down those better performing providers, which is clearly not a desirable policy outcome.

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3.36. With regards to competition, if only six or seven Master Trusts remain, as is likely with a £25bn AUM threshold, this will demonstrably reduce competition, will likely stifle innovation and will consequently detract from member outcomes. This could partly be overcome by reducing the minimum AUM threshold to £5bn, with a glidepath to greater scale over a longer timeframe, perhaps a decade or two, which would ensure greater competition and enable the retention of some very well performing schemes that frequently outperform their larger peers.

3.37. The league table proposal outlined by the SPP, above, would not disincentivise high quality entities from entering the provider market. The metrics in the league tables would provide clear markers that a prospective entrant knows they have to meet and would allow them to assess their ability to meet the markers in advance of entering the market.

3.38. As an example, the league tables could include the following metrics:

- 5 year per annum net of fee returns for a member 10/20/30 years from retirement.
- 5 year per annum net of fee returns divided by volatility for member 10/20/30 years from retirement.
- Administration fee (calculated after a new entrant has been in the market for 3 years).
- Ratio of asset flows into the default versus those leaving the default over a 3-year period.

3.39. Any prospective entrant will be aware of the criteria used to assess member outcomes and will be incentivised to enter the market only if they have a business plan that can be shown to have achieved the criteria through back-testing and be credible on a forward-looking basis.

3.40. Alternatively, a league table could be based on some standardised members (with given hypothetical contributions) of different ages, where the regulator/government requires the provider to make theoretical calculations (given certain assumptions for the allocation) of what their pension outcome would have been over various time periods e.g. a member 10 years before retirement, 10 years ago now reaching retirement; a member 25 years from retirement and a member 40 years from retirement etc.

3.41. The Dutch regulator publishes standardised ALM data sets which providers are then also required to calculate outcomes under, in order to check that the glidepaths are not taking excessive risk with members' pensions. Given the ambition for the size of the defaults/providers, this would seem to be something which multi-employer providers (at the very least) should be able to carry out and report on to the regulator and/or publish.

3.42. Whatever metrics are agreed, these will need to be constructed in such a way so as to avoid, or at the very least minimise, the risk of herding as occurs in the Australian market.

3.43. **Recommendation 4: Again, the SPP does do not believe that policymakers need to specify a £25bn AUM minimum size. Alternatively, the Government should consider the introduction of industry league tables, constructed using a concise set of metrics that holistically assess member outcomes that are calculated by a trusted source. This is likely to be a more effective approach.**

3.44. **Question 5: Do you think there should be targets for (i) achieving a reduction in default fund numbers down to a single fund and, (ii) setting incremental minimum AUM?**

(i) Target for reducing default fund numbers

3.45. Reducing the number of provider level default strategies, especially where this reduces the number of poor performing legacy defaults, appears reasonable.

3.46. We would further support the initial focus being on legacy GPP products bearing in mind the overall volume of AUM contained within these contracts that are unlikely to be providing value for members or investing in productive finance. We believe this would go a long way to helping the Government achieve its objective of improving member outcomes and facilitating greater investment in private assets.

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3.47. However reducing default arrangement numbers down to a single arrangement would be a very extreme step with potentially serious consequences for employer choice, member experience and responsiveness to climate and other ESG concerns. The SPP recommends that if there is a reduction to the number of defaults, a reasonable number of options should be allowed, taking into account the various factors discussed in our responses to Questions 1 and 7.

3.48. Whilst a step plan for reducing defaults or increasing size may be sensible, we would see that plan starting no earlier than 2030, not finishing in 2030. This would be a significant project and will require resources to manage. Please also see our response against Question 1 on how to approach combining all the various pension reforms which have been or are about to be put out for consultation or development to avoid significant waste of resources and effort.

(ii) Target for minimum AUM

3.49. The proposed incremental approach implies that organic and inorganic growth over an extended period is linear, whereas this is unlikely to be the case. Moreover, inorganic growth through consolidation may well become very difficult for the foreseeable future. It is conceivable that one or more of the current providers that would be forced to exit the market if these changes to legislation did proceed may look to raise legal challenges.

3.50. One area that may be particularly vulnerable to challenge is the proposal to impose a minimum AUM by a set date. The case put forward in the consultation paper relies heavily on research papers referencing overseas experiences that are not directly comparable and which suggest benefits such as in-house investment capability, access to wider asset classes, and 'other scale benefits' only start to arise at £25bn-£50bn. However, there is clear and contrary evidence available (including the CAPA data included within this consultation paper[6]) that demonstrates that this has not been the case in the UK. Indeed, as already referenced above, the consultation document itself acknowledges the fact that, *"…there is no consensus on the optimal size of a DC pension fund."*

3.51. Providers who could be negatively impacted by the proposed minimum AUM levels (or any incremental measures between 2025 and 2030) may be expected to challenge the proposed changes and equally to resist acquisition approaches in the interim. That might cause the further consolidation of existing master trusts to stall.

3.52. Again, it would seem somewhat counter intuitive, as well as contradicting many of the Government's objectives, to push out of the market providers that have the in-house investment capability and are producing some of the best outcomes for their members (as can be evidenced in the CAPA data[7]), simply based on an arbitrary measure of scale not supported by any of the evidence provided.

3.53. Therefore, if a minimum AUM requirement is introduced, we would encourage government to explore creating exclusions for high performing smaller default arrangements, perhaps using the VFM metrics to create an exempt category, or an alternative minimum quality requirement. This might offer reassurance that the default arrangements that remain are those of whatever size clearly delivering good net returns and those which are of sufficient scale that they ought to be capable of it (following the logic of the consultation paper).

3.54. **Question 6: Are there any potential barriers/challenges that should be considered in reaching a minimum size of AUM at default fund level before a future date, such as 2030?**

3.55. Yes, engaging widely across our membership, it has become clear that there could be many barriers and challenges in reaching a minimum size of AUM by 2030, particularly reaching such a large size of £25bn AUM.

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[6] **Pension fund investment and the UK economy, 27 November 2024:** **https://www.gov.uk/government/publications/pension-fund-investment-and-the-uk-economy/pension-fund-investment-and-the-uk-economy**

[7] **Ibid**

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3.56. Perhaps most importantly for this consultation – and government's overarching objective - these barriers may continue to prevent government from achieving its goals for delivering benefit from large, consolidated default arrangements and any subsequent increased investment in productive finance.

Safeguarding members' best interests

3.57. Imposing limits on default arrangements and thresholds on minimum AUM may drive savers out of non-qualifying default arrangements which are withdrawn from the market. However, that transition may not be because it is in those savers' interests, but simply because they cannot stay in the existing funds. The transition will be at the expense of savers' savings, particularly those close to retirement age.

3.58. Whether a transition to another, larger default arrangement is in the interests of existing members of a default arrangement will depend in part on whether the costs of transition will be outweighed by the benefit of being in the transferee fund. Members that have a narrow time horizon to make back any costs from projected potential gains from the consolidation process are much less likely to reap any benefit and may never recoup the transition cost.

3.59. Whilst moving to a single default arrangement or at least fewer default arrangements can currently be achieved by master trust providers, absent compulsion the relevant trustees need to be assured first that such a move will be in the members' best interests. That means obtaining professional advice to that effect. That advice is likely to need to include an analysis of transition costs and in particular any adverse impact to members close to target retirement age.

3.60. This is not a straightforward process and if trustees are focused on members' best interests, they may feel compelled to leave many cohorts in default strategies that are not achieving government objectives, because it is difficult for trustees to justify moving them on.

3.61. Although the Consumer Duty is subtly different to the trust regime, we would expect similar considerations to be taken into account by IGCs (or other relevant decision-makers).

Creating market uncertainty

3.62. The consultation has already created barriers to those yet to achieve the proposed minimum AUM scale, having placed a large degree of uncertainty in the minds of potential clients and their advisers as to any smaller providers' ability to remain in the market. This will inevitably lead those providers to be selected against in favour of those that have already achieved – or are very close to achieving – the required scale, even if the defaults (when referenced in the CAPA data attached to this consultation[8]) are not providing the evidence that scale brings better outcomes for members.

3.63. We understand that government is less concerned about this immediate distortion of the market. However, we believe that that the longer-term impact on innovation, new market entrants and member experience may have been underestimated and should be further analysed.

Value vs costs

3.64. Whilst we very much welcome the Government's new focus on value for members and improved outcomes over cost, as the consultation paper has identified, the majority of provider selection processes over the past decade have very much focussed on cost.

[8] **Pension fund investment and the UK economy, 27 November 2024:**
https://www.gov.uk/government/publications/pension-fund-investment-and-the-uk-economy/pension-fund-investment-and-the-uk-economy

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3.65. If the Government includes sufficient exemptions to avoid forcing high quality providers out of the market and if the increased focus on value for members leads employers, trustees and their advisers to revisit their decisions, we might expect and look forward to a reversal of the downward pressure on cost. However, it is unlikely that such a reversal could be achieved in the suggested timeframe. We would therefore encourage a much lower initial target and a much longer timeframe for escalation to the sorts of volumes anticipated by the consultation paper.

3.66. We have a separate concern that the proposed, extremely fast, timeline could have the undesirable effect of rewarding providers who adopt unsustainable pricing (potentially also with poor member outcomes) in order to ensure they reach the minimum AUM and/or out-compete sub-minimum AUM providers purely on the basis of the uncertainty created around these providers' futures. If the government does intend to include either an exclusion for high performing funds, or an alternative quality test (see above), we recommend announcing that sooner rather than later before providers with excellent member outcomes and/or investment in productive assets are forced out of the market by uncertainty.

Regulatory framework

3.67. Introducing minimum AUM requirements, whether at the default arrangement or default arrangement level, is likely to force the consolidation of master trusts. However, whilst the consultation paper notes that – unlike the contract-based market - there are mechanisms in place for the merger of master trusts within the authorisation framework, these were designed for a disaster scenario and not for an orderly transfer.

3.68. The SPP therefore recommends that the Master Trust legislation is revisited to open up the ability to use ordinary scheme merger principles to conduct a conventional scheme merger, subject to the transferee scheme being an authorised master trust. The current mechanisms are not fit for the purpose of an orderly transition.

3.69. Overall, we believe that the forced consolidation of the current market by the proposed 2030 deadline is unlikely to assist government in achieving its goals to drive benefits for members through large, consolidated default arrangements and a subsequent investment in productive finance.

3.70. However, we believe that facilitating without consent bulk transfers for contract-based arrangements will allow greater consolidation (as set out in Chapter 3 of the consultation) and introducing league tables to incentivise providers to deliver the most attractive net of fee risk-adjusted returns (as set out in question 3 above) will have a greater impact.

3.71. **Question 7: Given the above examples, what exclusions, if any, from a required minimum size of AUM at default fund level and/or the maximum number of default funds requirement should government consider?**

3.72. Please see our comments above on whether there is any case for a minimum size of assets.

3.73. It is worth noting that the issue of exemptions becomes less challenging if the minimum threshold of AUM was reduced from £25bn to £5bn.

3.74. The Government also needs to consider the additional layer of visibility that will be introduced through the ongoing regulatory initiatives aimed at improving VFM and encouraging consolidation in the auto-enrolment market. These should be robust enough to tease out any poor performing schemes to allow for natural consolidation at a quicker pace.

3.75. We have identified the following categories of schemes/funds that should be excluded from the proposed reforms. They are listed in no particular order of priority. We have set out below the list a brief explanation for each proposed exclusion and also suggested some other areas for investigation and consideration.

- Sharia-compliant default arrangements;
- high performing schemes/default arrangements;
- CDC schemes;

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- accidental master trusts;
- accidental defaults; and
- other niche schemes.

Exclusion for Sharia-compliant default arrangements

3.76. If the Government decides to proceed as planned, Sharia-compliant default arrangements, aimed at meeting the needs of Muslim employers and the UK's 3.9m Muslim population, should be exempt.

Exclusion for high performing schemes/default arrangements

3.77. Given the smaller schemes which are producing better returns for investors, the Government may wish to consider a broader exemption for all default arrangements that are e.g. delivering saver returns above the industry average or some such similar measure. This could be either an exemption, or an alternative test. Such an exemption would fit perfectly with the Government's expressed intentions to promote a better outcome for savers.

Exclusion for CDC schemes

3.78. At least until the new type of multi-employer CDC pension arrangement is firmly embedded in the UK, we would suggest an express exclusion for CDC arrangements, including master trusts (see below response to question 9 for more detail).

Exclusion for accidental master trusts

3.79. We would recommend excluding "accidental master trusts" from the ambit of this proposed legislation. Accidental master trusts are the non-retail not-for-profit DC schemes (or DB schemes with an element of hybrid benefit) which were historically established for a particular industry or other grouping of employers with a common interest but no common ownership (i.e. non associated employers), but which were rolled into the DC authorised master trust regime when it was introduced in 2019 (or later when they added DC). Examples include the Universities Superannuation Scheme (USS) (the principal pension scheme for certain staff in universities and Higher Education Institutions in the UK), the FCA Pension Plan (shared by the FCA with the Financial Ombudsman Service for DC purposes) and SAUL (the Superannuation Arrangements of the University of London).

3.80. Accidental master trusts were not set up as businesses, and as a general rule are hybrid schemes which started as defined benefit schemes for non-associated employers and then opened a DC section for some or all of those same employers when the DB section closed to future accrual. In each case the trustees were required to apply for and maintain authorisation for their DC section as a DC master trust because it is sponsored by employers which are not legally connected.

3.81. These schemes do not share the characteristics common to commercial master trusts – there is no "provider" as such and their approach is paternalistic. Although for the purposes of the authorised DC master trust regime they must have a "scheme strategist", they have more in common with "single employer schemes" than the commercial MT/GPPP space. In general, they are not open to employers outside the specific remit embedded in their rules and there is no strategy for growth or for profit. There will not, by the very nature of these existing plans, be any new entrants to this section of the industry – this is a closed group.

3.82. We see the thrust of the proposed reforms as only really relevant to commercial arrangements being provided as a business. The majority of authorised DC master trusts fall into that category, as do all group personal pension plans, but the accidental master trusts do not.

3.83. We would suggest an express exclusion, by reference to the existing list of DC authorised master trusts, to endure as long as the named schemes remain outside the commercial arena.

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Exclusion of accidental defaults

3.84. Default arrangements can be created effectively by accident, as a result of non-consensual bulk transfers between funds or schemes where members self-selected more than five years prior to transfer. [9] If the member's past savings become treated as being in a default arrangement, then the underlying funds could become, effectively, default arrangements. We would suggest that such accidental default arrangements are clearly excluded from the definition of "default arrangement" for the purposes of each of the two proposed thresholds.

Exclusion for other niche schemes?

3.85. There may be an argument for excluding certain other schemes that serve a niche market. For example, a bespoke tailored proposition that may not be adopted by the eventual mega funds on the grounds of cost and risk but that better suit the type of employers and savers it attracts. An example might be for employers whose employees are likely to have particular views on ESG issues (e.g. an environmental charity). Currently such employers may work with consultants to devise a bespoke default arrangement which reflects relevant values and beliefs – for example, using default arrangements which have a "climate tilt". That option would be removed under the current proposals.

Other ideas for exclusions

3.86. We have suggested above that any limit on the number of default arrangements should be separate from any minimum AUM threshold. In other words, there should be no limit on the number of default arrangements which are over the threshold in question.

3.87. We have suggested in our response to question 8 that to encourage innovation there should be an exempt 'growth period' during which time any new arrangements can focus on building scale.

3.88. There should be no maximum number of defaults where common component funds are used with in the default strategies.

3.89. **Recommendation 5: Government should consider a broad exemption for smaller funds that outperform their larger peers. CDC, Sharia compliant default arrangements and other schemes that serve a niche market should also be exempted.**

3.90. **Question 8: With regards to the proposals in this chapter, we anticipate the need for mechanisms to encourage innovation and competition, and for safeguards to protect against systemic risk. Are there other key risks that we need to consider? How do we mitigate against them?**

3.91. There are likely to be risks to individual members/savers being transferred from one master trust to another or from one default arrangement to another as a result of these proposals. There is particular risk that if small pots have transition costs applied, they will be eroded with no real means of recovery, potentially leading to poorer outcomes for members. The same risk applies to older members with little time left to recoup the costs. There is also out of market risk should a transfer not be enacted via novation or in-specie - this can be mitigated using methods to avoid this particular risk such as pre-funding although this does also involve a cost.

3.92. It would be naïve to suggest that providers should simply absorb such costs, which could be substantial and negate the advantages of consolidation. There will be a real cost to any transition forced by the proposed reforms, without any equal and opposite value improvement, and it is not clear that this has been considered.

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[9] **Regulation 4(4) of The Occupational Pension Schemes (Charges and Governance) Regulations 2015 (SI 2015/879)**

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3.93. Innovation is key - typically we see new players innovate as they spot gaps in the market and are nimble enough to react. For example, technology, communications, additional services including financial wellbeing and so on. Healthy competition is demonstrably good for the market and forces change. We do have a concern that innovation at the fund level will be stifled if the number of default arrangements permitted is limited, or a minimum AUM is required.

3.94. We see a very clear and significant oligopoly risk if minimum AUM is set high. A few large players – six or seven master trusts – may end up controlling the market just because of their existing size. That should not be allowed, especially where such master trusts have poor track records on administration, innovation and/or investment.

3.95. We see a short-term risk of a further price war as competition for limited assets intensifies. A price war may sound superficially attractive if it reduces costs to savers, but it is more likely to reduce the investment budget for productive assets. For this reason, we encourage early announcement of proposed exclusions, and a significant reduction in the scale of any minimum AUM threshold that might be introduced.

3.96. Poor member experience/service and excessive cost with schemes consolidating is a real risk. The Master Trust Regulations need changes to enable swift consolidation of master trusts in particular. Recent reports about merged master trusts having to trigger a wind-up event – and this being anything but a smooth transition for members - serve as a useful example. And the costs of such difficult transfers will come from savers' accounts.

3.97. Fewer larger scale schemes will require greater regulatory oversight, as opposed to less, but this may be counter-balanced by the reduction in the number of schemes. The oversight regime will need to adapt and evolve so that new and emerging risks such as lack of innovation can be dealt with through the requirements set. This may see regulators needing to scale up and recruit staff with different but complimentary skill sets.

3.98. The proposed standardised Value for Money framework could be enhanced such that reporting MI provides some insight into innovation plans, but at the risk of stifling competition as publication of such plans will remove first mover advantage. A better solution, if reporting on innovation is needed, could be to require confidential reporting to the appropriate regulator.

3.99. If the Government proceeds with a requirement for a minimum AUM threshold for default arrangements, then it should avoid creating barriers to entry by introducing an exempt 'growth period' during which time any new arrangements can focus on building scale. There needs to be a reasonable amount of time to enable this or else it is likely to have the opposite effect and not attract new players.

3.100. **Recommendation 6: If the Government proceeds with a requirement for minimum AUMs, then it should avoid creating barriers to entry by introducing an exempt 'growth period' during which time any new arrangements can focus on building scale.**

3.101. **Question 9: Under a minimum AUM model, competition in the market could be more restricted. Would additional exceptions be required to ensure innovation can continue to flourish?**

3.102. Under a minimum AUM model, competition in the market will almost certainly be restricted, especially if the minimum AUM is set at such a high bar as the £25bn suggested. £25bn AUM for a default arrangement would take any new entrant many years to achieve. That makes it a clear brake on innovation and competition and likely to eradicate any chance of market disruptors materialising. A clear pathway for new entrants would need to be established, whether this is a specified timetable or milestones or some other measure. Again, as we have stated elsewhere in this response, a smaller AUM threshold of £5bn would partly address this challenge.

3.103. One obvious example of a necessary exemption is for CDC schemes. The SPP strongly suggests a careful and nuanced approach to determining whether and how any minimum AUM should apply to CDC schemes. There are several reasons why a minimum AUM threshold would not be appropriate, at least initially, for CDC schemes, as explained below

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3.104. <u>CDC scheme design and scale</u>
By design, CDC schemes pool all assets into a single fund with an overarching investment strategy. In multi-employer CDC schemes, there may be one fund per section, but relatively few sections overall. Unlike traditional DC schemes, CDC schemes do not offer member-level investment choices, inherently driving efficiencies and creating large funds. This structure aligns with the Government's objective of improving scale and value.

3.105. <u>Regulatory oversight</u>
The existing comprehensive authorisation and supervisory regime for CDC schemes is designed to prevent the sub-scale challenges historically observed in DB and DC schemes. This robust framework mitigates the risks that a minimum AUM threshold seeks to address.

3.106. <u>Barrier to establishment</u>
Imposing a high minimum AUM threshold, particularly in the short term, could present an unnecessary hurdle for employers and providers seeking to establish CDC schemes. CDC schemes may not receive significant transfers from existing DC arrangements on day one; instead, assets build up gradually through new contributions. Setting a minimum threshold by a specific date could unintentionally prevent new CDC schemes from being established, stifling innovation and uptake.

3.107. <u>Industry-specific CDC schemes</u>
It is possible that multi-employer CDC schemes may be established to focus on specific industries or sectors that prefer not to pool risks with unrelated industries, as has been the case historically with the "accidental" authorised DC master trusts we identified in our response to question 7. While sufficient scale is required to justify a CDC scheme, realistically not all CDC schemes may target the £25bn scale that the consultation paper proposes for traditional DC. However, these industry-focused schemes could still deliver significant value within their intended scale.

3.108. <u>Investment efficiencies</u>
CDC schemes, by design, expect to allocate higher proportions of assets to growth investments, productive finance, and private or illiquid markets compared to traditional DC schemes. This investment flexibility means that CDC schemes can achieve the benefits of scale at a lower overall fund size, while also supporting government objectives to channel more capital into productive investments.

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

3.110. Multi-employer schemes with fewer defaults – as the Government is intending – will likely become easier to merge into other multi-employer schemes, given there will be fewer different investment strategy set-ups involved.

3.111. However, there is a question as to how the market dynamics of mergers will operate if the Government's intended approach is pursued. There is little incentive for providers to undertake an expensive and risky consolidation exercise of their default options if there is a risk that they, in any case, will later merge or be taken over by another provider. More certainty may encourage lower resistance to undertaking such consolidation exercises and speed up the overall consolidation process.

3.112. Pricing may be a consideration, if the resulting outcome of mergers leads to price increases for certain groups of members, this may have legal or communication hurdles (see single pricing under Question 11).

3.113. Some form of governmental marketing campaign to explain what is happening will be helpful, and potentially essential. This is not only to raise awareness and understanding but to minimise the risk of pension scams - there is a risk that if members suddenly begin receiving lots of information about pensions, they may disregard it because of a fear of being scammed, or worse, may fall prey to an actual pensions scam.

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

3.115. To clarify, we have interpreted "single price" as including both administration and fund management charges.

3.116. There may be several issues for providers seeking to consolidate employers into a single price. Unless the cheapest price of all the employers using a default is adopted, this will inevitably mean fee increases for some employers and their members, which would potentially introduce legal and communication hurdles.

3.117. Individual DC schemes are generally relatively straightforward to administer (compared to DB or CDC). However, there will be employers who have more complex arrangements which lead to additional one-off and/or ongoing administration work being required. We therefore question whether a single price (including administration) would be fair on other employers (and their members) whose arrangements are straightforward. Similarly, some providers will offer employers a 'menu' of services, the choice from which is likely to directly influence charges and, potentially, investment options.

3.118. Marginal asset management and administration costs usually reduce with size of AUM. If a single pricing model was pursued, we believe it would still be necessary to have room to have a single fee tariff (rather than a single fee percentage) which allowed for larger employers and members to receive a discount. Some costs, in particular administration, are also better represented by a per member cost so we would expect there to be room within any such requirements for these to be applied in a different manner to costs based on size of assets managed.

3.119. Single pricing clearly removes much of the room for employers to negotiate with providers. It is difficult to anticipate what impact this would have on the market. It potentially would encourage employers to look in more detail at other important factors – net returns, customer service, ease of onboarding. However, there is also the risk that this would further intensify the focus on price as the key driving factor of decision-making. This may have the negative effect of meaning providers look for cheaper investment strategies and cheaper administration options, in order to keep their prices low. There is therefore no guarantee that this leads to improved pension outcomes and member experience. It may, in fact, lead to worse outcomes, and also less differentiation and choice in the market.

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

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

3.121. Depending on the type of contract, members can be transferred on a negative affirmation basis already, but the SPP welcomes the development of a mechanism to allow for unilateral activity by providers where this is appropriate, and with suitable protections.

3.122. However, taking a step back, the proposals will essentially enable providers to move customer money to new products and new investments without customer consent. Such activity is not to be taken lightly. It is therefore important that it is reserved for circumstances which genuinely merit such activity. There may need to be some additional regulatory support to determine what would be permissible in the way of risk of member detriment, in particular in relation to small pots and/or where savers are close to target retirement age so risk not recovering the costs of transfer.

3.123. This would most logically be tied to an assessment of poor value, linking up with the FCA's consultation CP24/16: The Value for Money Framework.

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3.124. In our response to that consultation [10], we noted (summarising) that:

- requiring transfer is a very severe solution – although where an IGC determines that an arrangement is not offering VFM and is not capable of doing so within 2 years, there is no obvious alternative that offers the saver any real protection.

- transfer may still not be the optimal solution – and it may be better for any legislative override to allow a variety of solutions in addition to transfer (which would normally be to another registered pension scheme) including:

- transfer to a new product delivered through the same registered pension scheme;
- without consent investment switches within the same product; and/or
- without consent changes to the product to enable delivery in line with modern, value products.

3.125. Clearly in each case there would need to be suitable checks and protections.

3.126. There may also be limited circumstances outside of the VFM assessment in which a provider might properly want to engage in changes (legal, operational and/or investment) which are not expressly enabled by the terms of policyholder terms and conditions. This can be the case where unfair terms/Consumer Rights Act 2015 safeguards together make it difficult to include and rely on very general variation rights.

3.127. We also note that some legacy policyholder terms and conditions do not include a written variation right.

3.128. This means that from time to time what appear to be logical, generally policyholder-friendly changes are thwarted by a lack of legal authority for the change. This may be a suitable opportunity to solve for that issue within a protective environment by extending any new unilateral transfer power to these circumstances too – with due consumer safeguards.

3.129. It may be sensible to provide for different or additional protections where a scheme or arrangement is closed to future accrual, and employer input is less relevant, compared with open schemes/funds/books.

3.130. We note the possibility of using this mechanism for small pot consolidation – but caution that separate principles and protections would need to apply for that process, even if this mechanism delivers some of the groundwork.

3.131. **Question 13. Do you think that an independent expert, such as an IGC, should be responsible for undertaking the assessment of whether a transfer is appropriate?**

3.132. We have some concerns over whether an IGC is an appropriate body to drive this process.

3.133. Part VII transfers and Part 26 compromises both rely on the input of an independent expert to provide additional consumer protection. There is therefore precedent for independent expert involvement in existing legal change mechanisms used in the workplace personal pensions space.

3.134. Transfers made between trust-based pension schemes without member consent rely on the agreement of the ceding trustee which owes a fiduciary duty to the members transferred when considering the transfer). There is therefore precedent for governance body involvement in existing legal transfer mechanisms used in other forms of workplace pension schemes. Transfers without consent between trust schemes also require actuarial certification (for DB benefits) and (in relation to non-master trust transfers) independent advice (unless the employers sponsoring the receiving and transferring schemes are part of the same group).

3.135. The purpose in each case is very broadly to ensure that policyholders/members are not disadvantaged by the change/transfer – and an assessment of this is undertaken with:

- independence (i.e. no conflict);
- accountability (i.e. liability); and
- competence (i.e. with either the expertise or the advice to be able to make a sound assessment)

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[10] SPP response to the FCA VFM Framework proposals, October 2024: https://the-spp.co.uk/wp-content/uploads/FCA-Value-for-Money-16.10.24-FINAL.pdf?v=6413

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3.136. It seems logical that there should be some scope for changes to proceed with independent professional advice/certification or an independent expert.

3.137. Some circumstances might lend themselves more to the former than the latter (or vice versa) and so the option should be available to go down either route. However, whether ultimate sign off should be from an IGC (or GAA) is subject to the considerations discussed in our response to question 14 below.

3.138. **Question 14. What, if any, changes may be needed to the way an IGC's role, or their responsibilities/powers for them to assess and approve contractual overrides and bulk transfers?**

3.139. Taking on responsibility for approving transfers without consent would fundamentally change the role of an IGC and the change requires very careful consideration.

3.140. A key feature of an IGC at present is that they are effectively on the same side of the fence as customers, with the provider on the other side. By making the IGC a decision-maker, policymakers are shifting them to the same side as the provider. It may be more prudent to retain the status quo, with providers accountable and IGCs acting as consumer champions.

3.141. In addition, it is worth considering that there have been different views given as to whether an IGC (or GAA) occupies a fiduciary role in relation to its present duties (and if so the extent of its fiduciary duties). It seems to us that any assessment and approval of contractual overrides and bulk transfers would be fiduciary in nature and require a high standard of care to discharge associated duties.

3.142. This would need to be reflected in the COBS rules and guidance, IGC (or GAA) terms of reference and the contractual arrangements under which IGC members (or GAAs) are appointed by the provider.

3.143. In particular (and as above) it would be logical for IGCs (or GAAs) be held accountable (and therefore liable) if they are found to have fallen short of the standard required in their decision making. Creating such accountability would represent a sizeable change in the status and set-up of an IGC (or GAA). Its responsibility would be much the same as the position for trustees sanctioning bulk transfers.

3.144. It was originally envisaged that IGCs (or GAAs) would be indemnified by providers under the terms of the COBs rules. However, this was not adopted in the final rules and so it is often included in the engagement terms of IGC members on appointment. If there is to be a fiduciary (or fiduciary-like) duty, then the FCA could revisit whether indemnification should be mandatory (except in the usual circumstances such as fraud and wilful default).

3.145. Finally, it is also worth highlighting the barriers to trust-based schemes consolidating into contract-based schemes. Currently if an employer switches from trust to GPP, they typically have to use a s32 buy-out. for the existing savings and set up a separate GPP. If a much more consolidated market is achieved, it is essential that all remaining schemes are viable consolidation destinations for competition purposes.

3.146. **Recommendation 7: For IGCs to assess and approve contractual overrides and bulk transfers, the COBS rules and guidance must be updated. If IGCs are to assume a fiduciary (or fiduciary-like) duty, then the FCA should reconsider whether indemnification should be mandatory.**

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

3.148. Many employers play a material role in relation to the default and fund range used at outset – and then from time to time – in workplace personal pension schemes. However, some of these employers become disengaged over time and no longer engage with consultants to maintain their default and fund range. This causes complex dynamics (contractual and regulatory) between employer, provider and member/policyholder that are not easy to resolve.

3.149. It would be a shame to deter engaged employers from developing and maintaining bespoke arrangements which they consider best fit for their own workforce. However, we expect employers who do this are unlikely to have workers in poor value or otherwise sub-optimal schemes.

3.150. Therefore, to resolve poor value and/or sub-optimal schemes, there is no specific need for employers to play a major role – although they could assume one voluntarily.

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3.151. Options include the following:

- requiring the provider/IGC to notify the employer/former employer of any proposal to transfer and give it the opportunity to nominate an alternative receiving scheme/product if it wishes; or

- give employers of active/contributory members a more proactive power to direct transfers if they wish (outside of any provider unilateral power) – along the lines of similar powers in some master trusts.

3.152. However, even the former (lighter touch) option is a significant step beyond simply selecting a workplace pension scheme. This step for employers involves a decision about moving pension member money to new products and new investments without member consent.

3.153. We have to consider carefully whether employers are equipped to make good decisions about this – or how they can be so equipped. This links into later sections of the consultation, regarding employer duties and professional advice.

3.154. We also consider that a role for employers is more compelling in relation to any active/contributory policyholders, since these are part of an employer's current workforce.

3.155. The role for employers is less compelling in relation to deferred/non-contributory policyholders and pensioner/drawdown policyholders. However, excluding this cohort from an employer power/duty may have pricing implications. In the master trust world where assets are more portable, employers of active/contributory policyholders can often gain better pricing in a receiving master trust if past balances associated with deferreds are part of the package. Whilst it might be attractive for workplace personal pension scheme assets to be similarly portable, employers would need to consider very carefully their regulatory obligations and wider liability exposure if making decisions about lifting and dropping their **former** workers into a new financial product with a new set of investments.

3.156. Another issue with splitting actives from deferreds is that differential pricing for the two cohorts may emerge if they are transferred to different schemes/products. This may have the effect of active member discounts, albeit not in breach of the prohibition.

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

3.158. If the transfer is to another workplace personal pension scheme/product:

- for ongoing auto-enrolment schemes, there must be a contract in place between the employer and the provider under s26 of the Pensions Act 2008. This commits the employer to paying minimum auto-enrolment contributions; and

- it is unlikely that existing s26 agreements would envisage a switch to a new scheme/product.

3.159. S26 agreements also often contain necessary associated commitments, roles and responsibilities and liability allocation between parties – alongside operational detail about contribution files, payroll and tax reliefs. This may change with a switch to a new scheme/product.

3.160. Therefore, we expect that new contracts would be required. If the transfer involves a move from one registered pension scheme to another, then the employer may also need to enter into new RAS certificates with HMRC.

3.161. If the transfer is to a workplace trust-based scheme, the employer would generally need to participate in the trust already and sign up to associated documentation. At present there is no legal transfer process for bulk transfers from contract-based personal pension schemes to trust-based scheme transfers – they are conducted as multiple individual transfers.

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3.162. **Question 17. What procedural safeguards would be needed to ensure that a new pension arrangement is suitable and in the best interests of members? What other parties should be involved and/or responsible for deciding the new arrangement?**

3.163. Before turning to the procedural safeguards, it is important to have legislative and regulatory clarity as to whether members' best interests should be assessed:

- at individual, cohort or collective level;
- as "balance of probabilities" or for all purposes and circumstances; and/or
- as purely financial in nature – or involving wider considerations.

3.164. What will be the most appropriate procedural safeguards will depend on how these tests are set by legislation and regulation.

3.165. There would also need to be clarity as to how this transfer mechanism interacts with what could be competing considerations arising under the Consumer Duty and the unfair contract terms regime. Otherwise, even if the mechanism can override the terms of customer contracts, it might be frustrated by concerns about falling foul of other legal and regulatory requirements.

3.166. However, in more general terms, the procedural safeguards listed below would be worth consideration.

- The transferring scheme/product must be:
    - red-rated under VFM assessment (with no realistic prospect of improving the rating to green through routine mitigation measures in a reasonable timescale); and/or
    - sub-optimal in some other way.
- The receiving scheme/product must be green-rated under VFM assessment.
- Transferring policyholders must not be exposed to the loss of tax protections and/or loss of key features such as guarantees.
- Measures are in place to address any out-of-market risk arising on the transfer.
- Independent assessment of value/non-detriment by an IGC (or GAA) or independent expert as appropriate – to confirm that the conditions for use of the mechanism have been satisfied.
- Professional independent advice must be taken by the decision-maker as to the impact on policyholders (and different cohorts of policyholders).
- Notification obligation and minimum information provision to the member/policyholder; and an opportunity to direct a transfer to some other receiving scheme/product by a particular date.
- Notification obligation to any employer customers in relation to (at least) the active/contributory policyholders who are included in any switch.
- Notice to the FCA that such mechanism is being used (or has been used) with confirmation that other procedural steps have been taken. This might also be an opportunity to explain to the FCA why other available mechanisms – such as exercise of existing unilateral rights (if any) or Part 26 arrangements were not considered appropriate or proportionate in the circumstances.

3.167. These are not intended to be exhaustive lists of safeguards and conditions for use.

3.168. Part 26 arrangements are currently used in moving/altering books of business in workplace personal pensions and other FCA-regulated products. These involve a member vote and court approval. We consider that Part 26 should remain the route for change projects of real substance.

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3.169. For the purposes of a more limited transfer mechanism, we generally consider court approval and policyholder vote to be a step too far. The cost and timescale would be a barrier to use.

3.170. **Question 18. Do you foresee any issues with regards to transferring savers from contract-based arrangements to either other contract-based arrangements or trust-based arrangements? If so, what issues?**

3.171. <u>Contract to contract</u>
If a policyholder is to be moved to a new product with new contractual terms, the transfer legislation also needs to deal with issues of inertia selling and distance marketing? We understand that the DWP explored this for auto-enrolment business – giving rise to the "deemed" contract which comes into play under the term of Pensions Act 2008 and associated regulations.

3.172. <u>Contract to trust</u>
Very few master trusts operate on a RAS basis – which is how tax reliefs on contributions are addressed in workplace personal pension schemes/products. Any switchover to a different tax deduction regime needs careful thought and could have varying impacts on different cohorts post-transfer.

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

3.174. See above answer to Question 17.

3.175. **Question 20. Are there any specific circumstances in which a transfer should not be allowed to take place, or savers should be able to opt out?**

3.176. We expect that, in most cases, opt-out will be:

- sub-optimal for policyholders, because that would leave them in a poor value scheme or product; and

- sub-optimal for providers, because it would require them to maintain a poor value scheme or product – possibly for an even smaller cohort of members.

3.177. If opting out (which, logically would need to be tied to a requirement to arrange a member-initiated transfer somewhere else or face a default transfer) might be in the policyholder's interests and practicable, it probably means that the transfer mechanism is inappropriate for the circumstances.

3.178. As part of the communications process, providers should be required to give notice of the impending without-consent transfer and give individuals the time and option of effecting a member-initiated transfer to an arrangement of their choice. We recognise this decision is more complicated for active members as they may wish to transfer out the accrued value of their account while still joining the new arrangement for future employer contributions under the designated receiving arrangement, but such process issues would not be insurmountable.

3.179. Specific circumstances where transfers should not be allowed to take place include those as identified in the consultation – being where detriment would arise as a result of loss of tax protections and/or loss of valuable features in the ceding scheme/product.

3.180. In the case of the former, we consider that the tax protections regime for bulk transfers could usefully be updated and encourage HM Treasury and the DWP to consult with HMRC in this regard.

3.181. In the case of the latter, we expect that the "give and take" nature of Part 26 arrangements will be a better solution than unilateral transfer.

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

3.183. See answer to Question 20 above.

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3.184. **Question 22. In what circumstances do you think consumers/savers should have the right to compensation or an individual right of recourse enforceable in court?**

3.185. We can envisage two circumstances:

- failure by the provider (and other stakeholders) to follow the process/conditions for use of the mechanism; and
- failure by the provider (and other stakeholders) to undertake their role at the standard expected.

3.186. In such cases – but only where consumers/savers are able to demonstrate a financial loss and a causal link – then it might be appropriate for compensation or an individual right of recourse enforceable in court but this should be no more or less than currently applies to members of trust based schemes where there is a breach of trust.

3.187. The rules will need to be designed in such a way as to leave little room for ambiguity about whether the provider did what was required. This is because too much ambiguity will probably mean providers and IGCs will be too fearful to use this, even if they are acting in good faith with appropriate due diligence and so on.

3.188. **Recommendation 8: In relation to contractual override without consent for contract-based arrangements, where the provider fails to follow the correct process or fails to undertake their role to the expected standard, and the consumer is able to demonstrate a causal financial loss, compensation or a right to legal recourse should follow but this should be no more or less than currently applies to trustees where there is a breach of trust**

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

3.190. See our response to Question 17 above in respect of notice, advice and considerations of detriment.

3.191. The other restriction might logically be that, where the receiving scheme is a trust-based scheme, it must be an authorised DC master trust. Otherwise, in theory transfers might be undertaken to single employer trust schemes and/or SSAS arrangements which are probably not fit for purpose.

3.192. **Question 24. Where the transfer is into a trust, should the duties of receiving scheme trustees be extended to ensure terms and conditions balance both the interests of incoming and current members?**

3.193. Yes. In such circumstances the duties should be extended.

3.194. This would typically be how any board of trustees of a receiving scheme would address bulk transfer-in proposals. They would need to be comfortable that they were able to look after existing members to the same (or better) standard after accepting the transfer-in, and also deliver the same (or better) standard as applies to those existing members to the new members being transferred in. However it is for the trustees of the transferring scheme to be satisfied of the standard of treatment to be applied in the receiving scheme if a transfer is to proceed.

3.195. Where the power to accept a transfer into a receiving scheme is not vested in the trustees of that scheme, either the duty would have to be applied to the person holding that power, or trustee agreement should be made an overriding pre-condition.

3.196. **Question 25. How should the cost of the transfer be borne?**

3.197. There should be some flexibility around this.

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3.198. There might be circumstances in which asset transition costs of moving money into new, “better” investments could and should properly be borne by policyholders. This could be taken into account in the assessment of best interests and benefit of transfer.

3.199. However, the overarching project costs, separate from the actual asset transition costs, could be substantial, and we would not expect these to be borne by policyholders.

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

3.201. If this is a closed scheme moving to a closed scheme <u>within the same provider</u>, there will need to be the following:

- investment advice, confirming the new policy is appropriate for members;
- legal documentation to allow and govern the bulk transfer;
- indemnity insurance for the IGC (which has no financial resources of its own); and
- member communications (including drafting, plus printing and postage) and member tracing.

3.202. The costs could easily be measured in six figures depending on the number of members/sums involved.

3.203. Then transaction costs must be factored in. How will the transaction be undertaken? Can the assets be novated across to the new policy? If not, will it require a sale and purchase of the old and new assets again? The costs here could easily be more than twenty basis points of the policy value. Finally, there is market risk, and how and whether this will be covered.

3.204. If the move is <u>to a new provider</u>, all the above applies, but in addition:

- legal documentation/advice for the receiving IGC; and
- implementation costs

3.205. This could add many tens of thousands of pounds onto the costs.

3.206. In addition, as assets will need to be sold and bought, transaction costs will almost definitely apply.

3.207. Factors influencing the costs will include:

- size of the transfer, both in asset value and number of members;
- any guarantees that are being given up, or other policy specifics (e.g. with-profits); and
- the choice of new default, which will impact the transaction costs.

3.208. There may also be complications as a lot of these policies are historic (which we expect to be the case) meaning that additional costs will need to be incurred on transfer (e.g., unit reconciliation) or later data cleansing (such as member tracing).

3.209. The market will have data on without-consent transfers within the trust-based regime - albeit these would usually be comparatively small arrangements compared with some GPPs.

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

3.211. The benefits to gain might include such things as a modern product with digital functionality, modern administration, a full suite of investments (and good investment governance), more comprehensive terms and conditions, and modern retirement options.

3.212. Members could, however, lose out in a variety of ways – examples below.

- Loss of functionality such as paper-based engagement or ability to pay contributions by cheque.

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- Loss of product features such as ancillary insurance benefits, with-profits investment, investment options, GARs and other forms of guarantees, and any bespoke pricing arrangements that might arise. This might even include loss of features never used.
- Out of market risk if, say, units are calculated on different days in the receiving scheme/product versus the ceding scheme/product.
- Poor investment outcomes in different scenarios (including some more likely than others); for example, if there is loss of value due to illiquid investments having to be forcibly sold in order to transfer value in a timely fashion.
- Loss of tax protections that can arise on transfers.
- Transition costs not being recouped e.g. because the pot is too small to recover, or the member does not have long before target retirement date.

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

3.214. Role for the FCA

3.215. As stated above, we expect that the FCA should be notified of any use of the mechanism. We are open-minded as to whether this is pre- or post-use of the mechanism.

3.216. If notification is pre-use of the mechanism, then the FCA is likely to need additional resource to be able to review and comment before the mechanism is used. This may be an unnecessary step if the process and associated conditions are well defined.

3.217. It may be more constructive (and in keeping with other regulatory procedures) to notify the FCA after the event – but with the provider (or IGC) being held accountable if there is any flaw in the process, see Question 23.

3.218. We note the possibility of the FCA mandating transfers, but this would need to be a matter of last resort if, for example, red-rated business had not moved within a reasonable period.

3.219. Role for TPR

3.220. We expect that the mechanism would enable transfer to trust-based schemes only where those schemes are authorised DC master trusts. This being the case, the role for TPR might be:

- authorised master trust to notify TPR that it has received a transfer-in from a workplace personal pension scheme (and to update its business plan as and when any significant transfers-in are anticipated). Since actual receipt of transfer payments is unlikely to be an early warning sign of distress, there is no need for this to be a triggering event or significant event in its own right; and
- possibly to restrict authorised DC master trusts from receiving such transfers unless they satisfy additional criteria or a higher level of authorisation. The criteria for this might be linked to business plans and reserves. However, this would be a fairly draconian change to the current regime. Any such restriction would require changes to the master trust legislation first, as there is no current overriding legislative or regulatory control on receiving transfers-in. The process is governed by trustee duties and the applicable trust deed.

3.221. However, we expect that transferring scheme/product providers would find it hard to justify a transfer to a poorly resourced master trust – so the second option may not be necessary in practice.

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3.222. Chapter 4 – Costs versus Value: the role of employers and advisers

3.223. **Question 29: Do you think establishing a named executive with responsibility for retirement outcomes of staff could shift from the focus on cost and improve the quality of employer decision-making on pensions?**

3.224. In principle, the SPP supports actions that are likely to result in better member outcomes but placing a duty on employers, or specific individuals, will certainly increase costs on these employers. Engagement with SPP members has elicited various views about the impact such a duty could have on business.

3.225. Of the UK's 5.5m businesses, over 4m do not employ anyone (aside from the owner) and of the remaining 1.4m, most are micro-entities employing fewer than 10 people. For these businesses, the owner/founder may well still be involved in all aspects of the business, but they are unlikely to have a management board in the way that large companies do. Similarly, most SMEs will not have a governance structure that would be able to encompass such a new responsibility.

3.226. Most management teams will be concentrating their focus on growing (or saving) their business and this additional duty could distract them from their core business.

3.227. A minority (of mainly larger) employers will already take – in varying degrees - an active interest in the operation of their work-based scheme. These employers are likely to pay for the services of one (or more) advisory firms to assist in assessments and advise on alternatives. The new VFM process should facilitate these assessments, but we cannot see what additional benefit is conferred by placing a statutory duty on a named individual.

3.228. We also think that if the Government does proceed with this new duty, its scope must be very clearly defined. Paragraph 118 of the consultation paper refers to "*a nominated executive with responsibility for ensuring the pension arrangement delivers good value retirement outcomes for staff*." But Question 29 asks about "*establishing a named executive with responsibility for retirement outcomes of staff*". We suggest that these are different matters, and the latter is much broader than the wording in paragraph 118.

3.229. It is also worth noting that the examples the consultation documents list - of additional requirements being imposed on employers - specifically relate to larger companies. For instance, modern slavery reporting (turnover in excess of £36m), diversity and inclusion concepts such as gender pay gap reporting (250 or more employees) and the Corporate Governance Code (applicable to listed companies). If these requirements were to follow such precedents, to only be imposed on larger organisations, this may make such a change more viable.

3.230. **Recommendation 9: The SPP believes that this statutory duty to have a named executive should not be introduced but that if it is, to limit costs and disruption, it should only apply to larger companies (250+ employees).**

3.231. **Question 30: What evidence is there that placing a duty on employers to consider value would result in better member outcomes? If such a duty was introduced, what form should it take? Should it apply to a certain size of employer only? How can we ensure it is easier for employers to make value for money comparisons?**

3.232. We are not aware of any evidence from either within the UK nor internationally supporting the introduction of such a duty. However, in the experience of SPP members, it has been generally found that the more engaged an employer is, the more likely they are to consider overall value and not just cost. And that employers who do not engage with their provider are more likely to be utilising older products providing poorer value.

3.233. The SPP membership strongly supports the principle that whether an employee receives "value" from their pension savings should not depend on the size of the employer they work for. However, this principle does have to be tempered with an acknowledgement of the realities for businesses in a challenging economic environment. As a result, members of the SPP hold mixed views on whether a duty on sponsoring employers should be introduced.

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3.234. On the one hand, if a duty were to be created, it would need primary legislation. There would almost certainly also need to be regulatory/supervisory guidance. This will increase costs and have resource implications for both businesses and regulators.

3.235. Employers would then need to establish, document and implement procedures in line with the new legislative/regulatory regime. They would also need to implement processes to monitor and review their arrangements. There is also likely to be a reporting cost as the regulators/supervisors would need to monitor adherence and perhaps implement intervention action for shortcomings/failures.

3.236. It is also a matter of fact that the vast majority of employers (tending to be micro-employers) are providing access to workplace pensions solely because it is mandatory to do so and not because of a passionate belief in the benefit of enabling the UK population to address the historic inadequacy of private pension provision or invest in UK businesses. There is no reason to expect them to be any more engaged in reviewing their selected arrangement – it is a distraction to their business at best, but also potentially introduces new risk if they decide to change provider and are later accused of getting it wrong.

3.237. However, on the other hand, employers are the primary "buyer" of workplace pension arrangements. And as stated above, it has been generally found that the more engaged an employer is, the more likely they are to consider overall value and not just cost. And that less engaged employers are more likely to be utilising older products providing poorer value. This demonstrates that employers can provide a valuable safeguard for ensuring the workplace pensions market delivers value for savers.

3.238. Therefore, if the Government does proceed to introduce a duty on employers, the SPP would recommend phasing it in, starting with the very largest employers (e.g. companies employing more than 1,000 employees) and not applying it at all to the smallest employers (i.e. companies employing less than 250 employees).

3.239. As legislation should be evidence-based, we recommend that the government should not proceed to roll out any such requirement to companies employing between 250 and 1,000 employees without first seeking evidence (of benefit) after the initial roll-out to the largest companies. If the evidence highlights that there is no discernible benefit to members (and there will be a discernible cost to business), the duty – even for the largest of employers – should be unwound.

3.240. The SPP would be more likely to support the introduction of an employer duty to assess value if that built on the requirements of the VFM framework and was "light-touch" in nature. For example, the requirement on the employer could be to (i) ensure that their employees are in a scheme that has been rated green in its latest Value for Money assessment and (ii) verify that the investment performance and services their employees are receiving align with those set out in the Value for Money assessment. The purpose of the proposed new VFM framework is to change the emphasis from cost to value and will enable employers and those responsible for running pension schemes to be able to compare their 'proposition' against those of others with an emphasis on taking action to wind up and consolidate if found wanting.

3.241. We are also acutely aware that this latest proposal comes on top of many other policy initiatives that are already in train within the pensions industry including the VFM framework, the small pots consolidation proposals and the introduction of pension dashboards. Each of these by themselves are requiring considerable investment and resourcing to achieve. We would be greatly concerned by the introduction of yet more duties before these are embedded.

3.242. **Recommendation 10: Whilst there are mixed views from members of the SPP as to whether or not an employer duty to consider value should be introduced, there is broad agreement for a phased approach should this be implemented and that small and medium sized companies (those employing less than 250 employees) should be exempt.**

3.243. **Question 31: What evidence is there that regulating the advice that some employers receive on pension selection will better enable them to consider overall value when selecting a scheme?**

3.244. We are not aware of any direct evidence domestically or internationally.

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3.245. However, as an analogy we refer to the “appropriate adviser” regime that has been in place since April 2018 governing advice that trustees must take when considering certain transfers of relevant DC rights without member consent. This is required by the Preservation Regulations (SI 1991/167) and supported by DWP guidance. Representatives of the SPP understand that this new facility has been successful in unblocking DC bulk transfers without consent in many situations and has been working well. Therefore, whilst pension selection by employers is not exactly the same as this, if the Government were to proceed with such a policy, then the DC transfer without consent legislation could serve as a model for how to achieve this.

3.246. **Question 32: What evidence is there that regulating the advice that pension schemes receive on investment strategies would enable more productive asset allocation? What type of regulation would be effective?**

3.247. If investment strategy advice were to become regulated, then that is likely to lead to more professionalism and greater in-depth knowledge on the part of those individuals offering this service. However, it is important to make the distinction between an increase in the quality of advice that regulation could lead to; and an assumption that this would result in more productive asset allocation. Investment strategy advice – whether regulated or not – should focus on the targets of a scheme’s trustees or managers who in turn should be prioritising the best outcomes for their scheme members. It does not follow that this will lead to more productive asset allocation.

3.248. Turning to regulation, Reg 34(3)(a)(i)(dd) of the Scheme Administration regulations (SI 1996/1715) refers to the adoption of a particular investment strategy as being part of investment consultancy services. Therefore, modifying this regulation to require the advice to be regulated would be a good starting point.

Chapter 5 – Impacts and Evidence

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

3.250. Collectively, SPP members have a great deal of experience in carrying out this activity.

3.251. In addition to the usual considerations for a DC-to-DC transfer, when consolidating single employer trust assets, the following also needs to be taken into account:

3.252. Employer subsidy to the single employer trust scheme - this is a relevant benefit to members that contributes to the overall value of the arrangement and which is often not available following transfer to a master trust or GPP. SPP members report that for unbundled single employer trust schemes, employers often pay the administration charge (usually as a fixed fee to the administrator). For bundled single employer trusts, this does not often happen. On transfer to a master trust, members pay the total charge.

3.253. Protections on DC benefits such as guaranteed rates for members - a commercial master trust or GPP may not be unable to offer these. Compensation for members may be necessary if the guarantees are lost, adding months to the consolidation process (and also additional cost to the employer, who as a result may be unwilling to proceed with a consolidation project).

Link to defined benefit section of the single employer trust scheme – commonly DC benefits can be taken in tandem with the DB pension (e.g. the DC pot is used for the tax-free pension commencement lump sum, so that the member does not need to give up DB pension in exchange for the lump sum). As a result, timescales for consolidating the DC section of a scheme can be driven by the readiness of the DB section to buy-out (i.e. transfer to an insurer). This process can take many years, and in some cases will be unattainable where the DB scheme has a significant deficit. That said, recently many DB schemes have been in a better position to transfer to an insurer.

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4. About The Society of Pension Professionals

4.1. Founded in 1958 as the Society of Pension Consultants, today SPP is the representative body for a wide range of providers of pensions advice and services to schemes, trustees and employers. These include actuaries, accountants, lawyers, investment managers, administrators, professional trustees, covenant assessors, consultants and pension specialists.

4.2. Thousands of individuals and pension funds use the services of one or more of the SPP's members, including the overwhelming majority of the 500 largest UK pension funds.

4.3. The SPP seeks to harness the expertise of its eighty-five corporate members - who collectively employ over 15,000 pension professionals - to deliver a positive impact for savers, the pensions industry and its stakeholders including policymakers and regulators.

5. Further information

5.1. For more information about this consultation response please contact SPP Head of Public Policy & PR at: phil.hall@the-spp.co.uk or telephone the SPP on 0207 353 1688.

5.2. To find out more about the SPP please visit the SPP web site: https://the-spp.co.uk/

5.3. Connect with us on LinkedIn at: https://www.linkedin.com/company/the-society-of-pension-professionals/

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