Consultation response

Pensions Review – unlocking the UK market for growth

Department for Work and Pensions, HM Treasury

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About this consultation

This consultation by the Department for Work and Pensions and HM Treasury is part of the Pension Investment Review, and follows the Call for Evidence run in 2024 which looked at consolidation and scale, value for money, investment issues, and the Local Government Service pension scheme. It considers implementing several policy measures designed to improve the performance of the defined contribution (DC) marketplace.[i]

Key points and recommendations

- The pensions marketplace is notoriously difficult for consumers to understand and navigate, and no matter what efforts are made, most savers will not be active participants in decisions about their pension arrangements.
- There would be winners and losers of a move to a single price, and the Government should undertake detailed modelling of outcomes for different groups of savers before making a decision.
- The charging structure needs to work well for employees of small businesses. This does not, however, necessarily mean removing differential fees altogether.
- The Charge Cap is the most important piece of consumer protection. We continue to believe the Cap should be cut to 0.5%, which is still above average industry charges and would drive better value for many savers, as well as forcing poor performing schemes out of the market. While we support efforts to define Value for Money, these should not detract from the importance of regulating charges.
- Enabling transfers without consent is fraught with difficulties. It is essential that governance is improved to ensure transfers work in savers' interests at all times, particularly among contract-based schemes.
- Independent Governance Committees vary in ability. They are not always able to operate in their scheme members' best interests, owing to a lack of expertise and information, as well as the lack of a legal duty to do so.
- A fiduciary duty, or similar Duty of Care, which gives savers a legal right to pursue malpractice claims against pension schemes through the courts would need to be introduced before it would be appropriate for contract-based schemes to receive transfers in.
- We are concerned that enabling contract-to-contract transfers could balloon into a financial scandal, making millions of savers worse off in their retirement.
- Trust-based schemes are better placed to receive transfers, owing to their superior governance arrangements. We recommend that if the Government pushes ahead with the allowing transfers, then only trust-based schemes are eligible to receive savers' funds.

About Age UK

Age UK is a national charity that works with a network of partners, including Age Scotland, Age Cymru, Age NI and local Age UKs across England, to help everyone make the most of later life, whatever their circumstances. In the UK, the Charity helps more than seven million older people each year by providing advice and support. It also researches and campaigns on the issues that matter most to older people. Its work focuses on ensuring that older people: have enough money; enjoy life and feel well; receive high quality health and care; are comfortable, safe and secure at home; and feel valued and able to participate.

Introduction

With the postponement of phase two of the pensions review, which was due to focus on adequacy, it is increasingly important that the nuts and bolts 'under the bonnet' of the pensions system work in a way that is good for savers. The investment and governance ecosystems are crucial for delivering good outcomes, and in a world where most people are not engaged with the detail of how their pension operates it is incumbent on the Government and regulators to design these ecosystems in such a way that ensures savers' interests are being protected and enhanced.

We are concerned that some aspects of the possible reforms pose particular risks for savers, most notably the prospect of transfer without consent from one contract to another. The relatively poor governance and routes of legal redress for savers in contract-based schemes mean that firms will be more likely to have regard to their own commercial interests rather than those of savers – we are very concerned that there will be an opportunity to arbitrarily increase charges or move savers into less suitable schemes, leading to a financial scandal that could make millions of people worse off in their retirement.

Because of this misalignment of interests, it should only be schemes operating under a fiduciary duty – or an alternative duty (such as a Duty of Care, which does not currently exist) – that are allowed to receive incoming transfers. As things stand, this means only trust-based schemes. The Consumer Duty is far from sufficient to achieve this goal. This is because the ability to seek legal redress through the courts for poor treatment is a great incentive to firms to treat their customers well, and is more likely to lead to better outcomes once people reach retirement.

Consultation questions

Questions 1-10, Maximum number of default funds

Age UK broadly agrees that increasing the size of default funds to generate scale can be beneficial for savers, providing consumer outcomes remain front and centre – achieving good outcomes for savers should be the main focus of reforms.

Q11 - How would moving to a single price for the same default impact positively or negatively on employers, members and providers?

There are pros and cons of this approach, and such a move would create winners and losers. There is also a significant risk that insurers, who are not governed by a fiduciary duty, would use the opportunity to generation additional revenue, obviously at their customers' expense and damaging long-term pension outcomes. This also highlights the potential pitfalls during the period of transition to a new regime. Ultimately, it is imperative that any system works well for employees of small businesses who are less likely to have the bargaining power to negotiate low fees – however this does not necessarily mean removing differential fees altogether.

We continue to believe that the Charge Cap is the single most important piece of consumer protection for pension savers. At 0.75%, it is set well above the DC average (0.48%)[ii], while many insurers currently charge considerably less – we are concerned that changing the system would encourage a rise in charges to many consumers who currently experience relatively low fees. With the current scepticism against charges as the main indicator of scheme value and ensuing focus on alternative ways of measuring such 'value', there risks being a severe weakening of consumer protection in pensions as firms may be able to argue that they deliver 'better value' via more opaque means that lead to worse outcomes for savers. In the absence of a fiduciary duty, and hence the ability for a scheme's customers to hold the scheme accountable through the courts, any reforms here and in the value-for-money space have a significant potential to cause serious long-term harm.

Age UK continues to believe that the charge cap should be cut to 0.5%, which would help drive both value for savers and consolidation/scale in the wider marketplace.

Age UK believes that prior to making any significant changes, a consumer-facing value for money measure should not only be available, but should be well embedded in the pension system. This means either developing a second consumer-facing metric, or ensuring that the model currently under development can be understood by consumers.

Any change of system in the contract-based marketplace would have to be scrubbed with a toothcomb to ensure that savers were not being taken advantage of. This is also true in the trust sector, although its superior governance arrangements give us greater confidence that trustees would continue to focus on good consumer outcomes. The Government should undertake extensive modelling of outcomes for different groups of savers to determine the best way forward.

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

Such a move is fraught with dangers and difficulties, as well as plenty of opportunities for consumers to experience poor outcomes. We are not confident that the current regulatory structure is capable of developing and applying a consistent and comprehensive set of rules to govern transfers. The split between the two regulators and types of pension is difficult to reconcile.

Transfers should only be allowed to happen when it is absolutely clear that it is in the savers best interests – and the only way of determining this is by placing a fiduciary duty on the receiving scheme in particular. The Consumer Duty is far from sufficient to give firms this level of responsibility – on introduction, an FCA Director said: “The firms must act in the best interests of retail clients is not intended or meant to introduce a fiduciary duty [*sic*].”[iii]

We would be concerned if transfers were enabled without serious improvements to governance arrangements for contract-based schemes.

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?

Independent Governance Committees are poorly placed to determine the appropriateness of a transfer. They have no specific requirement to understand a saver’s best interests and may not be tooled up with the correct information or expertise to ascertain the relative merits of a transfer.

The provision of essential information requires full cooperation from their sponsoring firm, which is not always forthcoming – the FCA’s thematic review of IGCs found that while there were no systemic issues, but that “some IGCs did not show sufficient independence from firms and did not effectively challenge firms in areas where members may be at risk of receiving poor value for money”. The extension of remit to improve how they consider both ESG and Value for Money issues will not improve IGCs’ cooperation or independence.

Even more worryingly, the FCA found that “many IGCs appeared to accept that charges in schemes were offering value, but it was unclear how they decided this or what specific measures or benchmarks were used to reach this view”. When placed in the current context this is particularly worrying – the review suggests the idea that the charge cap (0.75%) should be the norm is commonplace, and if this approach was taken forward it would be hugely detrimental to consumers, with large numbers of people exposed to significantly higher charges, undermining retirement saving plans for millions of people. Any reforms that undermine the competitiveness of the marketplace should not be undertaken.

The FCA has not, to the best of our knowledge, taken meaningful, practical action to ensure some of its negative findings from the review are corrected, suggesting that the regulatory regime around governance for GPP schemes would fall short in protecting many savers. Making it work for consumers would require the introduction of a meaningful course of redress for consumers who are let down by ICGs, ideally through the courts to put them on a par with trustees. A regulatory regime that allows enforcement of the rules by and for savers would be a minimum, but given the historical failings of the FCA on enforcement action we do not believe would happen in practice.

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?

The pensions marketplace is notoriously difficult for consumers to understand and navigate, with the Office of Fair Trading famously stating that “the buyer side of the DC workplace pensions market is one of the weakest that the OFT has analysed in recent years.”[iv] While some changes were made as a result of the OFT report, consumers’ behaviour has not – both savers and employers are often ignorant about pensions (although for employers offering a pension under auto-enrolment has at least become the norm), and are all-too-often ill-equipped to take what can be extremely complex decisions.

As the FCA itself states: “Most people still lack the support needed to make critical choices about their pensions. Decisions on saving, investing and how to use their life savings are critically important, and some may struggle to make the right choice for them without help."[v] However the FCA is barking up the wrong tree – no efforts to improve consumer engagement through changing the definition of financial advice or through industry initiatives to alert savers to more information will help address the fundamental failings.

It would be necessary to impose a fiduciary duty, or at least a 'Duty of Care', to their sponsor-firm's customers. There is currently no direct requirement or incentive for them to work in the customers' favour, which runs counter to the Government aims of enabling beneficial transfers, and will put a block on the effective of the proposed small pots consolidation regime. Enabling customers to utilise a legal route to challenge any decisions by the IGC would be essential, or the sponsor-firms will not have a strong incentive to prioritise offering incoming or existing customers good value in the "weak" pensions market.

While many steps recommended by the OFT have been implemented, the fundamental problem remains that "most employees do not engage with or understand their pensions. Pensions are complicated products, the benefits of which occur, for many people, a long time in the future."[vi]

IGCs are subject to a weak regime, with little scrutiny or independent oversight, as well as the absence of a legal duty to act in their sponsor-firm's customers' best interests. As noted above, the FCA review found evidence of mixed quality within the sector. It is essential it is significantly tightened up with proper oversight, accountability, and legal routes to redress for customers (via a fiduciary duty or a Duty of Care).

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

We do not believe it is reasonable or appropriate for most employers to have a role in the transfer process. Most businesses are SMEs and lack sufficient knowledge of pensions that would enable them to take a decision in their employees' (and ex-employees') interests.

Allowing transfers would be akin to moving the goalposts for many employers who wish to look after their employees' futures – the employer would select a scheme at the outset, yet if their employees' existing DC funds could be moved at any point it could undermine the employer/employee relationship. It could also implicate employers in malpractice or a scandal if a transfer isn't handled correctly and fairly.

It could also be the pensions of former employees that are being transferred, for whom there is no-one watching out for their welfare. Until April 2016, it was permissible for schemes to charge dormant members higher fees – a scandalous practice that was only outlawed after pressure from the Work and Pensions Select Committee and Parliament. 'Active member discounts' were not pursued by the regulators at the time, even if they privately voiced concerns about them and were supportive of the changes. This is pertinent here as it suggests that the regulator may not have the political capital to pursue consumer-friendly changes as part of a new regime for allowing transfers[vii].

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?

We are concerned that a R-A-G (traffic light) system that indicates the high-level Value for Money of a scheme, and furthermore is aimed at professionals, will not be enough to indicate a transfer is suitable.

We believe that only the introduction of legal protection for scheme members, through a fiduciary duty or Duty of Care placing a legal requirement to act in members' interests will be sufficient.

We have seen no evidence that the Consumer Duty has made a difference to savers in workplace pensions, and do not believe it is sufficient to enforce positive change in this opaque and difficult marketplace. While there is a degree of evidence of business practices changing in other sectors since the introduction of the Consumer Duty, this is not the case here. We are concerned that if the FCA is tasked with developing a regime for transfers, it will fall back on the Consumer Duty and blithely assume that changes will work in consumers' favour – if so, they will be wrong, and it will be a recipe for disaster. Much more impactful regulation will be needed.

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?

Yes, we foresee potential issues with transfers, in particular if savers are moved from one contract to another. Transfers should generally be allowable into a consolidator once the proposed changes to small pots are in force, however transfers without consent should be capped at the £1,000 cut off for a 'small pot' and should only be made into trust-based arrangements because of the conflict inherent within contract-based schemes.

Contract-to-contract transfers
If providers are allowed to transfer customers from one contract-based arrangement to another, we foresee a financial scandal in the making – and we do not use this phrase lightly.

In the absence of a firm legal duty and legal route to redress, there will be little to stop a scheme moving its customers to a higher charging or poorer performing contract (i.e. one that is more profitable for the provider) – especially when they are dormant members who are no longer a direct concern of their ex-employer who negotiated the arrangement.

The OFT's 2013 finding, stated earlier, about the weakness of the buyer side of the marketplace remains pertinent and it will only be a matter of time before there are serious issues that leave some savers thousands of pounds worse off in their retirement.

We do not have confidence that the FCA will implement a fair and workable regime here, as it has failed to spot significant developments in the past which have led to serious consumer detriment. And without the proper governance and reporting systems it would be harder to spot potential serious consumer detriment.

Enabling contract-to-contract transfers may leave the Government open to legal challenge, especially if scheme governance remains poor and any new regime does not significantly improve consumer protection.

Transfers into trust
While there are potential issues with transferring into trust-based arrangements, the conflicts of interest would be reduced. Furthermore, any malpractice would be mitigated by the existence of the trustees' fiduciary duty to act in their members' best interests, and the existence of a clear legal route of redress, through the courts if necessary.

The vast majority of insurers active in the workplace pensions marketplace already operate a master trust – improving Value for Money in these should be the priority, while in our view only trust-based arrangements should be used as receiving vehicles for transferring customers.

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?

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?

Age UK does not have a strong view about the role of employers, but we feel a sympathy with small employers many of whom will not have the skills or knowledge to take responsibility for their employees' pensions. This may result in poorer retirement outcomes for some. The regulatory regime should be focused on ensuring that schemes are providing excellent quality pensions, with responsibility resting at their door, backed up by rigid enforcement of a clear set of rules.

If any duty is applied, it should be to larger employers only. However, until a fully functioning and embedded Value for Money framework is operational, this feels like an unrealistic ask, and even when it is, a simple R-A-G rating system is likely to be too vague to help employers make truly informed decisions.

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[i] https://www.gov.uk/government/consultations/pensions-investment-review-unlocking-the-uk-pensions-market-for-growth

[ii] Department for Work and Pensions, Trends in the Defined Contribution trust-based pensions market; DWP, Pension Charges Survey 2020
https://assets.publishing.service.gov.uk/media/5ffef4f5d3bf7f33ba58deaa/pension-charges-survey-2020.pdf

[iii] https://www.moneymarketing.co.uk/news/fca-new-consumer-duty-is-not-a-fiduciary-duty/

[iv] Office of Fair Trading (Sept 2015), Defined contribution workplace pension market study

[v] https://www.fca.org.uk/news/press-releases/millions-people-could-get-more-support-their-pensions-under-new-proposals#:~:text=FCA%20consumer%20research%20shows%3A,(Financial%20Lives%20Survey%2C%202024)

[vi] Office of Fair Trading (Sept 2013), Defined contribution workplace pension market study

[vii] The provisions implementing this ban are: DC occupational pension schemes, in the Occupational Pension Schemes (Charges and Governance) Regulations 2015, SI 2015/879, reg 11; Workplace Personal pension schemes, in COBS 19.6.11–12