DWP Retirement Decisions Call for Evidence Policy Team
By email:
caxtonhouse.retirementdecisionscallforevidence@dwp.gov.uk

The Investment Association
Camomile Court, 23 Camomile Street,
London, EC3A 7LL
+44 20 7831 0898
imran.razvi@theia.org
theia.org
@InvAssoc
@The Investment Association

5th September 2023

Dear Sir/Madam

RE: Investment Association Response to a consultation on 'Helping savers understand their pension choices'

The Investment Association (IA) welcomes the opportunity to respond to the DWP's consultation on helping savers understand their pension choices. We strongly support the freedom for pension savers to structure their investment for retirement according to individual circumstances. However, the additional choice does place extra responsibility on the individual, and we therefore also support a strengthened process that helps people access support when making their decumulation decisions.

We have previously engaged with the FCA's work on investment pathways for non-advised DC investors and have called for DWP to introduce a support framework to cover the trust-based segment of the market. We are therefore pleased to see the proposals being put forward in this consultation. Our answers to selected consultation questions are attached, with our key messages as follows:

A duty on trustees to offer a decumulation service should be introduced: This should include a high-level default approach suitable for the generality of a scheme's membership. Where trustees do not offer a service, they should arrange for their members to be able to purchase the service in question from an external provider, such that their members are ultimately able to access all options consistent with the pension freedoms.

The design of the decumulation service and associated default should be left to trustees: This will allow for a diverse range of approaches that are best suited to the characteristics of an individual scheme. It is not appropriate for the regulation to prioritise any one type of decumulation approach, including CDC. Trustees are best placed to make the decision based on the needs of their own membership.

The use of CDC in decumulation could have potential benefits. However, it is a complex and as-yet untested approach in the UK that may not be appropriate for all members. Instead of an immediate focus on CDC, more thought should be given to how best to deliver income through in-scheme individual drawdown, which will be far more achievable in the near term for most providers.

A guidance framework for member decision-making will be helpful: We agree with the approach of setting out a series of questions and suggest a number of amendments to align them better with the Pension Freedoms. It should be possible to set out a guided decision-making process without trustees crossing the boundary into providing regulated advice, in line with the FCA's approach to decision-making under investment pathway rules.

Value for money in decumulation requires a range of metrics alongside charges: For decumulation products where the customer retains some investment exposure, asset allocation, performance and risk metrics all remain important to assess value for money. We emphasise that there is an additional need to focus on income generation and sequence of return risk when considering drawdown products.

Charges are clearly an important part of the value for money equation in decumulation as for accumulation. However, the services offered are likely to be quite different from those in accumulation. Decumulation charges should therefore be considered on their own merit, relative to the services provided.

Partnering arrangements will likely be widely used across the decumulation market: Some schemes will offer the full range of options with others choosing to focus on offering a sub-set of products. Government's role is to ensure that the proposed duty on trustees will lead to scheme members having access to all possible decumulation options, either with their existing scheme, or facilitated through another provider. With the duty in place, the market should be left to develop the terms and scope of any partnering arrangements.

We do not see a role for a centralised decumulation service unless and until it has been proven that the market is failing to deliver one or more of the decumulation options permitted under the pension freedoms.

NEST should be allowed a role in decumulation: We support the proposal to extend the duty to offer decumulation services to the NEST trustee board, with the caveat that NEST's focus is on its existing membership. This will give NEST the ability to innovate to deliver retirement income solutions for its members, just like any other provider.

I hope this response is helpful and I would be happy to discuss further.

Yours Sincerely,
Imran Razvi
Senior Policy Adviser, Pensions & Institutional Market

Response to selected consultation questions

Helping savers understand their pension choices

About the Investment Association

The IA champions UK investment management, supporting British savers, investors and businesses. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base and manage £10.0 trillion of assets. The investment management industry supports 122,000 jobs across the UK. Our mission is to make investment better. Better for clients, so they achieve their financial goals. Better for companies, so they get the capital they need to grow. And better for the economy, so everyone prospers.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people’s resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks and shares ISAs. The UK is the second largest investment management centre in the world, after the US and manages over a third (37%) of all assets managed in Europe.

In-scheme decumulation services

Q1: Should it be up to trustees to determine the other suitable suites of products?

We support the idea that trustees should have a duty to offer decumulation services that are suitable for their members and consistent with the pension freedoms. This should include a default approach but does not mean that a scheme must offer all options under the freedoms in-house: it may not be commercially viable to do so, and the risk of requiring a provider to offer all options is that it acts as a barrier to entry and results in a less competitive market, with reduced choice and innovation for members.

Instead, where trustees do not offer a service, they should be required to arrange for their members to be able to purchase the service in question from an external provider, such that their members are ultimately able to access all options consistent with the pension freedoms.

With regards to the default approach, we agree that the any legislative approach should be high level, requiring trustees to put in place a service suitable for the generality of their membership, but not prescribing what the approach should be. This will allow trustees to put in place a decumulation default that is suitable for the circumstances of their scheme’s members, enabling the implementation of a diverse range of approaches. This could include specific solutions such as in-scheme drawdown or external annuities, or a different approach whereby members are provided with access to advice alongside externally provided services.

We recommend that trustees should be required to review the choice of decumulation service periodically e.g. every 1-3 years, to ensure that it remains appropriate for the scheme's membership given any change in demographics, or other circumstances.

Q2: What can government do to help a CDC-in-decumulation market emerge?

CDC could in theory be an attractive option for decumulation: from a member perspective, the focus on retirement income, with little need for engagement in relation to decision-making, could address some of the challenges around complexity in decumulation that some members struggle with. Allied to this, risk-sharing across members has the potential to deliver smoother outcomes.

However, these benefits are theoretical for now: CDC as yet remains untested in the UK, and there should be some caution in encouraging its use as a decumulation option until multiple CDC schemes have been established and tested through a full economic cycle. CDC schemes are complex in relation to their design and governance structure and will need significant governance resource. Member disclosure will require clear and transparent disclosure of the cross-subsidies inherent in the scheme, and the framework under which benefits are set and then subsequently adjusted will need to be transparent and carefully explained in order to build member trust.

Further, CDC schemes are best tested in own-trust employer pension provision where there is no competition between schemes. This is because competition may drive providers to compete on target income levels that could end up being unsustainable. The experience of Equitable Life is instructive in this regard.

CDC may also be incompatible with the thrust of pension freedoms: CDC functions best when there is a large membership base across which to share risk. This means that restrictions may be needed on members' ability to take their entitlement out of a CDC scheme if these schemes are to succeed. Such restrictions would be incompatible with the spirit of the pension freedoms.

Instead of an immediate focus on CDC, more thought should be given to how best to deliver income through in-scheme individual drawdown, which will be far more achievable in the near term for most providers. While this does not permit for risk-sharing across members, it is still possible to build well-diversified portfolios that can target income levels or be built around certain withdrawal rates. Trustees choosing to offer drawdown as the scheme default can set default withdrawal rates or income targets that are sustainable and based on the needs of the membership. This addresses some of the complexities around member decision-making in individual drawdown as well as avoiding the additional complexities of CDC. Members who do not believe that the default income/withdrawal rate is appropriate for their circumstances retain the right to opt out of the default.

With high quality in-scheme drawdown options offered first, CDC schemes will have sufficient time to be set up and tested before being made available on a decumulation-only basis to members of DC schemes.

Q3: We would welcome views to understand what are the minimum requirements that trustees should put in place for members facing decumulation?

At a minimum, trustees should provide scheme members with generalised information[1] on all the options available to them under the pension freedoms, a default approach to decumulation (which could include access to whole-of-market advice rather than a specific decumulation service) and then information on how to access all the options for decumulation under the pension freedoms, whether they are provided in-scheme or not.

Q4: What factors should a trustee/scheme take into account when developing their decumulation offer?

The trustees should be aiming to offer a decumulation service that best meets the needs of the majority of their members. Of course, the nature of a default is that it can never be perfect for all members, but trustees should consider whether a specific approach i.e. drawdown, annuitisation, cash or UFPLS is likely to be the most suited to their membership as a whole, or whether the provision of access to whole-of-market advice is likely to lead members to make better decisions based on their own circumstances.

Such considerations could be aided by trustees carrying out research into the needs of their membership, as a number of schemes have done in relation to the design of their accumulation phase default arrangements.

For those trustees that seek to put in place an investment-based approach to decumulation, it is critical to have an awareness of the importance of the sequencing of investment returns – the timing of when investment gains and losses occur – since this can mean the difference between a good and a poor member outcome in retirement. Mitigating sequencing risk will require trustees to consider correlations between different asset classes in different market environments, in order to build a well-diversified portfolio that is capable of avoiding large drawdowns while helping to secure the desired retirement outcome.

<u>Guiding member decision-making and the advice/guidance boundary</u>

Q5: We would welcome views to understand if these are the right questions to capture the majority of ways an individual will want to use their pension wealth?

Q6: Are there any other questions we should include in the framework?

<u>Combined answer to Qs 5 & 6</u>
While the questions listed in the consultation document are sufficiently broad to capture all the options available under the pension freedoms, they are perhaps too generalised and rely on an individual having some prior knowledge of the options available to them. For example, the question about regular income could cover both drawdown and annuities as these both provide a regular income. Asking people if they want ‘flexible access’ to their pension is something that we would expect most people would answer yes to, without realising precisely what this means. Asking members if they want to do ‘something else’ assumes prior knowledge about the other options that are available to them.

[1] As opposed to information based on personal circumstances, which may take trustees uncomfortably close to the advice/guidance boundary.

The questions could therefore benefit from more precision that better aligns with the options available under the freedoms. For example:

- Do you want a regular, guaranteed income? [Describes an annuity]
- Do you want a regular income that is not guaranteed and may vary, but gives you more flexibility and control over your money? [Describes income drawdown]
- Do you want to leave your money invested and take out money as and when you need it? [Describes UFPLS/leaving money invested]
- Do you want to take your money fully as cash in the short term? [Describes a cash option]
- Do you want to do a combination of these things?

These questions better align with the choices available under the pension freedoms as well as the FCA's rules on investment pathways. The precise wording is just a suggestion, and we think schemes may want to engage in some consumer testing to arrive at language that they think will best suit their membership.

Q7: We welcome views on whether you see any issues with this approach and whether there are potentially any implications due to the advice/guidance boundary.

We think it should be possible to frame a series of questions without crossing the advice/guidance boundary. The FCA's investment pathway rules[2] set out an approach to ensure retail clients are offered the pathways and guided to make their own choice, in such a way that firms do not accidentally cross the boundary into providing advice.

It should be possible to design a similar approach for trust-based schemes such that members can be given information about their options without receiving advice that a particular course of action is suitable for them.

<u>**Value for money in decumulation**</u>

Q8: Do you have any suggestions for key metrics or areas that would need to be included if the proposed value for money framework was extended to decumulation or suggestions for where proposed metrics may no longer be required?

For any decumulation product where the customer retains some investment exposure, asset allocation, past performance, investment charges and risk metrics (particularly maximum drawdown) remain important to assess value for money. However, there is an additional need to focus on income generation when considering drawdown products, since income is the main objective in these products.

In such cases, the level and stability of income delivered against the product's objective, as well as the impact of withdrawals and returns on the remaining capital, will be a critical outcome-based assessment of value for money.

The role of forward-looking projections will need to be considered carefully. They would have to be adapted to be useful, focusing on features such as the level of confidence around a target level of income, and the combined impact of withdrawals and projected returns on the remaining capital invested. These would likely be complex projections and

[2] See COBS 19.10.14R – 19.10.28R

would need to be tested with customers to see if they provided decision-useful information.

Q9: Do you have safeguards in place for members in the decumulation stage? If so, what are these safeguards and what information do you provide to members?

Q10: Do you use the same charge structure as you do in the accumulation stage?

Combined answer to Qs 9 & 10
While these questions are best answered by pension providers, we make a broader comment that the services offered in decumulation may be quite different from those in accumulation. Accordingly, charging structures and levels in decumulation may differ from those in the accumulation phase.

That being the case, regulators should not seek to impose price regulation or take any approach that results in competition where a focus on price ends up inhibiting innovation. Instead, decumulation charges should be considered on their own merit, relative to the services provided, and not from the starting point that accumulation and decumulation charges should be in line. Extending the value for money framework to decumulation, with the additional income-focused metrics described above, is likely to help in that regard.

Partnering arrangements for decumulation

Q11: We would welcome views to understand what are the practical considerations of partnering arrangements?

Q12: Should government set out a minimum standard partnering arrangement?

Q13: a) Should all schemes be allowed to establish partnership arrangements or only schemes of a certain size? b) If only a certain size what should that be?

Question 14: Is there a role for a centralised scheme to deliver decumulation options, where trustees are unwilling or unable to offer these directly?

Combined answer to Qs11-14
In general, we expect partnering arrangements to be widely used across the decumulation market. While some firms may be willing and able to offer the full range of decumulation options permitted under the pension freedoms, others may choose to focus on specific areas of the decumulation market and offer only a sub-set of products.

The government's role is to ensure that the proposed duty on trustees to provide their members with decumulation services means that scheme members have access to all possible decumulation options, either with their existing scheme, or facilitated through partnership with another provider.

With the duty in place, the market should be left to develop the terms and scope of any partnering arrangements. Where schemes have met TPR's standards for operating in the market (e.g. through master trust authorisation) schemes should not be limited on the basis of size, or any other factor, from entering into partnering arrangements. Nor do we support minimum standards for such arrangements unless and until it is demonstrated that the market has failed to deliver high quality partnership arrangements.

Similarly, we do not see a role for a centralised decumulation service unless and until it has been proven that the market is failing to deliver one or more of the decumulation options permitted under the pension freedoms.

Implementation

Q15: We would welcome views on if there is an alternative to our approach for legislation that would achieve the same results?

Q16: We want to work with industry during the implementation of these proposals; what timeline should we work to implement these changes?

Q17: When we introduce legislation should this only apply to Master Trusts in the first instance?

Combined answers to Qs15-17
We agree that trust-based scheme members should benefit as soon as possible from the type of support already available to members of contract-based schemes through FCA rules.

In light of constraints on parliamentary time, we therefore support the DWP's approach of working with TPR to issue guidance that shows how the DWP's policy objectives can be met in the absence of legislation.

However, in doing this, it is critical that DWP signals clearly that the legislation will underpin the approach already set out in guidance. If there is any prospect that the legislation, once passed, will require a different approach, this will cause schemes to wait until legal clarity arrives.

With respect to scope, we suggest the duty covers all trust-based schemes and not just master trusts. This will ensure that members of all trust-based schemes have access to support. While we think it is unlikely that own-trust schemes will offer decumulation services themselves, they can make use of partnerships with external commercial providers to ensure that their members can access the full range of decumulation services.

The role of NEST in decumulation

Q18: Do you have views and evidence on how this can be delivered in ways that achieve our policy aims of stimulating CDC in decumulation, enabling Nest to provide the services outlined in this consultation, while ensuring a healthy competitive marketplace?

We have previously supported NEST being able to offer decumulation services to its own members and agree with commentators who have said NEST's offering should be targeted only on those who the market does not serve, in light of the financial backing NEST has from government, through its loan.

We therefore agree with the proposal to extend the duty to offer decumulation services to the NEST trustee board, with the caveat that NEST's focus is on its existing membership or any customers who the market is unwilling to serve.

Extending the duty to NEST trustees will give NEST the ability to innovate to deliver retirement income solutions for its members, just like any other provider. As with the design of accumulation stage default investments, we think NEST will play a positive role in the market by showing that innovative approaches are possible.

With respect to the possibility of NEST delivering a CDC solution in decumulation, while this is ultimately a matter for the government and NEST to decide, our comments in our answer to Q2 about the need for CDC schemes to be tested first, apply equally to NEST. However, we think the risk of competition leading to unsustainable income targets may be lower for NEST in relation to commercial providers since NEST will not be competing directly with them. In that sense, NEST may be better placed than fully commercial master trusts to offer CDC in decumulation.

Impacts

Q19: Are you able to quantify any of the one-off or on-going costs at this stage?
Q20: Are you able to provide a breakeven point in pot size for providing certain decumulation products or services? Would this be different for decumulation only CDC's?

Q21: What benefits do you expect there to be from the proposals members/schemes/wider)? Do you think they are quantifiable?

Q22: Do you think the benefits from the proposed changes outweigh the costs?

Combined responses to Qs19-22
These questions are best answered by pension providers.