PENSIONS POLICY INSTITUTE

PPI

"Bulk transfers of defined contribution pensions without member consent: draft regulations" consultation – Response from the Pensions Policy Institute

Summary

- The Defined Contribution (DC) landscape in the UK is somewhat fragmented, with a large number of schemes and variation in quality across the market.
- Further consolidation has the potential to positively impact member outcomes in retirement.
- Although some of the evidence from overseas is conflicting, if all the potential benefits of DC pooling could be realised in the UK, this could lead to better member outcomes through increased pot sizes and as a result a better standard of living in retirement.
- Current regulatory requirements may act as a barrier to further consolidation.

Response

1. This is the Pensions Policy Institute's response to DWP's "Bulk transfers of defined contribution pensions without member consent: draft regulations" consultation.

2. The Pensions Policy Institute (PPI) promotes the study of pensions and other provision for retirement and old age. The PPI is unique as it is independent (no political bias or vested interest), focused and expert in the field, and takes a long-term perspective across all elements of the pension system. The PPI exists to contribute facts, analysis and commentary to help all commentators and decision-makers to take informed policy decisions on pensions and retirement provision.

3. This submission does not address all of the specific questions in the consultation. Rather, the response provides an overview of the findings of a recent PPI report "The impact of DC asset pooling: International evidence" that relate to the benefits of pooling that could potentially be achieved through further consolidation that may be enabled by the removal of regulatory barriers proposed in the draft regulations.

4. A copy of the full PPI report "The impact of DC asset pooling: international evidence" is attached. This research explores international

examples of large DC pension funds and the lessons they may offer the UK.

The DC landscape in the UK is somewhat fragmented, with a large number of schemes and variation in quality across the market

There are currently around 35,000 DC schemes (including both trust and contract-based) in the UK, of which around 90% (32,000) are 'micro schemes' with fewer than 12 members. However, these micro schemes only account for a relatively small proportion of accounts (around 3%), and many are Small Self-Administered Schemes (SSAS) or executive pension schemes, in which many members are either trustees themselves or directors of the organisation. Members of such schemes are free to consolidate, transfer or wind-up should they wish to do so.

There are around 3,000 DC schemes with more than 12 members (covering 97% of accounts) and at present there are around 130 schemes with more than 5,000 members, comprising around 90% of accounts. Master trusts have become more prevalent as a result of automatic enrolment, with 59% of auto-enrolees becoming members of these schemes.

Despite the introduction of automatic enrolment and some consolidation having occurred within the DC market, savers who remain in smaller or older schemes may be at risk of achieving less positive retirement outcomes than they would in a larger or more modern scheme. Small DC schemes in the UK have been found to underperform larger schemes in terms of governance and operational charges. They are also more likely to have higher charges than larger schemes.

Further consolidation has the potential to positively impact member outcomes in retirement

Areas in which pooling could potentially impact member outcomes include:

- Reduced administrative and/or investment costs;
- Implementation of improved governance practices on a scheme and fund level;
- The capacity to increase or access expertise which also has the potential to reduce costs, as well as potentially leading to better returns and/or reduced volatility;
- Scope for greater portfolio diversification and access to alternative asset classes.

Although some of the evidence from overseas is conflicting, if all the potential benefits of DC pooling could be realised in the UK, this could lead

to better member outcomes through increased pot sizes and as a result a better standard of living in retirement

Evidence of the benefits of pooling DC funds in the countries studied (Australia, South Africa, Mexico and Italy) is somewhat mixed. Some large Australian funds are able to offer charges more than 40% lower than smaller funds, while usually around half of the top ten performing funds in any year are also among the top twenty largest. However, large schemes in Mexico, while offering lower charges, are not outperforming their smaller counterparts. This may be in part because of regulations and economic circumstances in each specific country studied.

In general, larger funds achieved through pooling and consolidation are associated with lower charges, improved governance and better access to alternative assets such as infrastructure. However, the benefits schemes achieve in practice are largely down to the strategies they choose to implement with their increased scale, rather than by virtue of scale itself.

Current regulatory requirements may act as a barrier to further consolidation

The Pensions Regulator (TPR) has acknowledged that the shift towards consolidation in the DC market that has occurred so far has now slowed, and it may be that there are some regulatory barriers to further consolidation.

Regulatory barriers include:

- The scheme must obtain consent from individual members in order to consolidate;
  Or
- The requirement of an actuarial certificate;
  And
- Conditions that must be met in the consolidating schemes' relationship to one another.

Removal of these barriers, as proposed in the draft regulations, may encourage schemes towards further consolidation, enabling them to achieve the scale necessary to access the potential benefits of pooling.

Achieving improved member outcomes through pooling is dependent on both the strategies implemented by schemes to achieve them, as well as the position of the scheme prior to pooling, rather than directly resulting from scale itself. For example, members of schemes with higher charges and/or lower quality governance would be likely to benefit the most from increased pooling.