



B&CE

# SAVING FOR THE FUTURE

*Extending the consensus on workplace pensions*

FABIAN  
SOCIETY

 bright blue



Nearly nine million people who would not otherwise have saved for a pension without automatic enrolment are now receiving matching employer and government contributions. Opt-out rates remain very low. Support has been sustained across the political spectrum.

This is testament to the quality groundwork undertaken by the Pensions Commission in the early 2000s and the care taken to build cross-party consensus.

Nonetheless, serious challenges remain. The Commission recommended that people should aim to generate an income in retirement equal to two-thirds of their salary. The challenges to this are two-fold: too many people currently fall outside automatic enrolment, and, of those in, too many are saving too little.

The Government's 2017 review into automatic enrolment could lead to further steps forward. Ultimately, we would like to see more people including the growing number of self-employed brought in. We would also like to see a debate begin on how much people should be putting into their pension.

We, at The People's Pension, are supportive of the review. We are part of not-for-profit B&CE Holdings. B&CE was set up in 1942, and is run by a board drawn from construction federations and trade unions to deliver employee benefits. With the launch of automatic enrolment, we used our experience to open a workplace pension open to all. The People's Pension now has over 3 million members. We provide low cost, high quality pensions focused on the needs of low and moderate earners. Our motto is "for people, not profit."

Our values (keeping promises, showing compassion and creating simplicity) inform what we do. We are active in arguing for public policy change to support people getting a decent retirement. In our conversations with policy makers, it seems clear that there are a range of shared views as to what needs to be done next to ensure good retirement outcomes for the British people. We hope that supporting the Fabians and Bright Blue to bring politicians and other thinkers together on this project will help sustain the original consensus in favour of workplace pensions. We also hope it will help carry forward that consensus to tackle some of the issues with which the Turner Commission was not tasked.

## CONTENTS

Foreword	3
<i>Ryan Shorthouse and Andrew Harrop</i>	
Finding political consensus	4
<i>Jeremy Cooper</i>	
Increasing participation	6
<i>Guy Opperman</i>	
The interests of the many	8
<i>Alex Cunningham</i>	
The default option	10
<i>Janette Weir and Iain Clacher</i>	
A decent income	13
<i>Frances O'Grady</i>	
A long-term business view	15
<i>Neil Carberry</i>	
Governance matters	17
<i>Jeannie Drake</i>	

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# SAVING FOR THE FUTURE:

## Extending the consensus on workplace pensions

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### FOREWORD

Ryan Shorthouse  
and Andrew Harrop



*Ryan Shorthouse is the founder and chief executive of Bright Blue and Andrew Harrop is general secretary of the Fabian Society*

Democratic politics is, at its heart, about finding solutions that compromise between different legitimate interests, values and people in our society. We make the most progress in tackling pressing problems when those from different political backgrounds and walks of life can shape and agree policies.

Look at Britain's impressive progress on mitigating harmful carbon emissions. There has been cross-party consensus on tackling climate change in recent decades, leading to the passing of the Climate Change Act in 2008 and the adoption of ambitious legally binding targets.

Important investment in the crucial early years is another example. Recognising its importance for parental employment and child development, governments of all colours since the mid-1990s have acted to increase the affordability and quality of childcare.

Pensions – specifically, the need to increase savings for retirement – has also been a critical issue that has attracted broad agreement between different interest groups and across the political spectrum. Automatic enrolment into workplace pensions, devised by the pensions commission in the mid-noughties under a Labour government and introduced by the coalition government at the start of this decade, is proving to be popular and effective.

But there is more to do. There are five particular policy issues with pensions that need urgent attention from politicians and policymakers: first, extending workplace pensions to more people; second, increasing default and voluntary employer and employee contributions; third, ensuring the tax system provides good support to lower earners; fourth, reducing the overall costs through scale, competition, regulation and product design; and, finally, ensuring government and other actors provide better advice and default pathways for individuals during working-life and retirement.

When it comes to future pensions policy, there is considerable common ground but no clear cross-party vision for the next stages of pensions reform. Bright Blue and The Fabian Society, representing the intellectual right and left, have a track record of coming together to find common ground and practical policies on pressing problems. We want to do that now with the next stage of pensions reform. This essay collection, which includes contributions from leading decision makers and opinion formers from different political and professional backgrounds, is the start of this conversation.

All our contributors, unsurprisingly, celebrate the success of automatic enrolment in workplace pensions. It is proof of the value of a steady, long-term, partnership approach. The same incrementalism continues to be valued, as our writers look forward towards the next stage of pensions reform.

The pensions minister, Guy Opperman MP, says he wants to examine the case for broader coverage and higher contributions, by building good evidence first. Neil Carberry from the Confederation

of British Industry (CBI) warns against higher compulsory employer contributions. But even Frances O'Grady from the Trade Union Congress (TUC) and Alex Cunningham MP, the Labour Party pensions spokesman, only want to see gradual change so that jobs are not put at risk. In the next stages of automatic enrolment there are reasons for thinking that consensus can be built.

Where our contributors disagree is on the breadth of the pension reforms they want to see. The Government's focus is almost exclusively on increasing saving. Others want reforms across a wider waterfront. There are calls for sweeping changes to ensure that pension funds maximise value for their members through scale, transparency and good governance – and that schemes can introduce new collective pension pots to pool investment risks.

The most important controversy is on the question of what should happen to pension funds at the point when people retire. This is a classic clash between liberalism and paternalism, which marks to some degree the intellectual traditions of our think tanks apart. Guy Opperman MP emphasises good advice so people can choose for themselves how to spend their money. However, Jannette Weir and Iain Clacher present consumer research to question whether this will ever be enough. They are among those who argue that the aim of a pension is to produce an income for life and we will need new default retirement options designed with this in mind.

To get the next stage of pensions reform right, the left and right need to listen to and learn from one another. The Fabians and Bright Blue will be continuing this conversation.

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# FINDING POLITICAL CONSENSUS

To address the many long-term pensions challenges, **JEREMY COOPER** argues for a permanent, independent pensions commission



*Jeremy Cooper is chair of retirement income at Challenger Limited. He was formerly the chair of the Australian government's super system review of workplace pensions*

**T**HE FIRST PRINCIPLE OF pension policy-making (workplace or otherwise) is that no change to the rules should be urgent or a surprise to those affected. Reform and changes are inevitable, but they should be made patiently in a disciplined and transparent policy framework. The UK's defined contribution workplace pension project is a long-term one built substantially on trust, given that employee participation is ultimately voluntary. Participants defer current day consumption for a very long time. In return, they should get plenty of notice of the potential for changes; why they need to be made; when they take effect; and so on.

This sounds easy, but the factors affecting workplace pensions are not static. The workplace itself has been changing. The labour market is fracturing into more self-employment: the so-called 'gig' economy. Workers have many more jobs in their careers. People are living longer and healthier lives. Corporates no longer want the risk of making concrete pension promises. This last development (the shift from companies offering defined benefit to defined contribution pension schemes) has transformed the pension itself.

Since the financial crisis of 2007–08, the UK has been affected by its fallout and ongoing fiscal pressures. Low interest rates, driven by quantitative easing and other factors, have seen income from retirement savings fall to their lowest level since the formation of the Bank of England in 1694. This combination has no doubt contributed to a policy programme that has appeared tactical, rather than strategic. But, this is only partly attributable to the post-crisis demands of the last decade. There are deeper problems. There is something about workplace pensions policy that suggests that it needs to be 'firewalled' from electoral politics, short-termism and budget night surprises.

A partial solution to these problems would be to install a permanent Pensions Commission to provide independent, informed long-term policy advice. There are many permutations of this idea, particularly regarding the scope of the mandate. One version is that any proposal for workplace pension policy reform would first have to be assessed by the commission against a set of high-level policy principles. The commission would report to parliament

on how the proposal measured up against the principles. It would be like the audible 'rumble strips' on a motorway. If a proposal were veering off the 'pensions motorway', the commission would report as much to parliament. Eventually, if the commission were effective, politicians would be wary of risking a negative report.

There is already support for a permanent pensions commission in the UK from bodies such as the International Longevity Centre UK, the Pensions and Lifetime Savings Association and Age UK. A proposal for a similar body is current policy of the opposition Labor party in Australia.

If a Pensions Commission is not feasible, or is a long way off, there is no reason why a long-term policy agenda could not be articulated by government. This enables reform to be focused on the bigger picture, rather than the day-to-day 'squeaky wheels'.

One of the first things that needs clarity is: what is the pensions industry? Is it a normal industry, like for example, food and grocery retailing; or is it more like healthcare – a highly subsidised and regulated utility? The answer is that the



pensions industry is in the middle, being akin to a public-private partnership. Pensions are a paternalistic social policy objective outsourced to the private sector. The roll-out of automatic enrolment represents a new market created by government intervention.

An industry where the customers are nudged, incentivised and subsidised by tax relief (£24.8bn for all registered pension schemes in 2016) should expect a higher level of accountability to, and direction from, government. If this were accepted, then a lot of policy decisions would become far simpler. As things stand, policymakers drift between free-market ideologies (e.g. former pensions minister Steve Webb's remark that pensioners should be free to spend their savings pot on a Lamborghini) and social paternalism (e.g. automatic enrolment, the default charge cap). A narrower field of play would greatly assist policy stability.

Once a proper ideological approach for pensions is determined, policymakers could tackle some of the remaining pension policy challenges in a more systematic way.

The standard of governance of pension funds remains an area that calls for a shake-up. There is a lack of professionalisation around the trusteeships of defined contribution funds in the UK. Coupled with that problem is the lack of scale efficiencies, with many funds being both poorly governed and lacking scale. The work that has been done with the local government pension scheme on governance standards and the pooling of small funds is a good signpost for what needs to happen across the industry. This would be difficult to achieve as part of the

day-to-day administration of workplace pensions. A better approach would be a thorough and considered review carried out by a permanent pensions commission.

Following the 'pension freedoms', there has been limited development of mass-market products that follow a default-like approach to meet the needs of typical retirees. Getting to the bottom of the reasons for this is another important part of getting pension freedoms to work effectively.

There is also something to be said for undertaking a holistic review of the technological aspects of pensions and whether the benefits of digitalisation and fintech are being fully employed. Even in this area, there is room for ideological differences to get in the way of good policymaking. There are some who would say that demand and supply and the free market should allocate capital here and that there is no room for government

There is something about workplace pensions policy that suggests that it needs to be 'firewalled' from electoral politics, short-termism and budget night surprises

intervention. These views overlook the agency problems and vested interests that are at play. Sometimes not implementing new technologies that empower consumers to make more choices or give them more information favours incumbent vested interests.

An example of this is common to both Australia and the UK. In the UK, there was a proposal called, 'pot follows member', the idea that 'stranded' pension pots could be prevented by automatically moving the pot to a new employer's fund if the member fails to tick a box for it to stay. This idea was effectively shelved in both countries for reasons that were more closely aligned to the interests of incumbent providers than consumers.

While still on technology, debates around the Financial Guidance and Claims Bill 2017, most notably on the pensions dashboard idea, are also instructive. There are a great many issues still to be resolved before data can be shared across so many platforms; it is potentially unworkable when you add in fiduciary duties and privacy concerns. But it can be done: in Australia, we have already implemented a government-administered pensions dashboard.

We all need to be able to live with changes to the workplace pension system, including how it is taxed. Many of the foundations on which such systems are built are in constant tension and movement. This makes change inevitable. The question is whether this is better achieved in the day-to-day fray of the political process or whether a supplementary, independent policy guidance or review process is preferable. Such a process could be either ad hoc, or entrenched as part of the policy framework. Either approach has the potential to achieve fewer and more coherent changes, with the salutary by-product of engendering more confidence in workplace pensions by those who will ultimately depend on them. ■

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# INCREASING PARTICIPATION

Automatic enrolment has been a success, greatly expanding the number of people saving for a pension. But now is the time for further reform, writes **GUY OPPERMAN**



*Guy Opperman is the minister for pensions and financial inclusion and Conservative MP for Hexham*

**D**URING MY FIRST few months as minister for pensions and financial inclusion, I've been struck by how much we've achieved in recent years to help people think smarter about planning for their retirement and have the opportunity to build up their private pension savings.

But for me, it is automatic enrolment, the government's flagship pension savings policy, which is fundamentally changing the way people save for the better. Launched in 2012, automatic enrolment requires employers to enrol all eligible staff – those aged between 22 and the state pension age, earning £10,000 per year or more and usually working in the UK – into a workplace pension.

As it reaches its five year anniversary, the transformation it is delivering in building a new pension savings culture across the country is an achievement of which we should be proud.

Prior to its introduction, between 2003 and 2012, there was a downward trend in workplace pension participation, from 12.3 million eligible employees to a low of 10.7 million.

But since its launch, nine million eligible employees have been automatically enrolled into a workplace pension and more than 800,000 employers have

met their duties – helping those workers to look forward to a retirement with more savings than they otherwise would have had.

To put that into context, these new savers outnumber the combined populations of Scotland and Wales. By 2018, we expect that figure to rise to 10 million eligible employees newly saving or saving more – rivalling the combined populations of Scotland, Wales and Northern Ireland.

**Four in five of today's eligible employees now see saving through a workplace pension as the normal thing to do if they work**

Automatic enrolment continues to bring more women into pension saving too – in fact the number in the private sector without a workplace pension has halved. This goes alongside an increase in participation across a range of income groups, industries and regions. It is estimated that there will be an extra £17bn of workplace

pensions saving per year as a result of automatic enrolment by 2019/20.

Many younger people may not have had access to a workplace pension at all before, but are now building up retirement savings for their future. In fact, 22–29 year olds have the lowest opt-out rate of all age groups. This underlines how automatic enrolment is such a positive achievement and undoubtedly one of the great social reforms put into place alongside the three million more people in work, two million new apprenticeships and the introduction of the living wage since 2010.

This success owes a great deal to the determination and support of the pensions industry and employers. Reaching this position of consensus has taken a lot of hard work, whether it's through the establishment of pension schemes or communicating these changes in the workplace.

The process began with large employers, many of which already provided some form of occupational pension. More recently, smaller businesses, which employ the great majority of our workforce, have begun to implement automatic enrolment for the first time. Just over 400,000 newly formed and existing employers must still enrol their staff into a workplace pension between now and March 2018, and we

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need to help them get this right. So it is essential that we continue to work with the Pensions Regulator to provide the necessary help and support so that these employers understand their responsibilities and how to implement automatic enrolment in the most straightforward way possible.

However we also recognise that the long-term success of automatic enrolment can only be sustained if people continue to understand the benefits of saving. With planned increases in minimum contribution rates to 5 per cent in 2018 and 8 per cent in 2019, putting money aside every month needs to be the default choice for people in work and the right thing to do for your future self.

That's why recent research highlighting how workplace pensions have become 'the new normal' is such gratifying news. Four in five of today's eligible employees now see saving through a workplace pension as the normal thing to do if they work. The figures also show that 80 per cent of employees are positive about the benefits of being enrolled into a workplace pension, 83 per cent feel they know where to go to find out more information, and 79 per cent would welcome increasing their savings alongside employer contributions.

Business owners regularly tell us that staff who feel supported by their employer are engaged and committed. In the current climate of record employment and a com-

petitive marketplace, what better way for business owners to demonstrate the value of their employees than by contributing towards their workplace pension?

But it is evident that our work is not yet complete. That's why we are now carrying out a review of automatic enrolment, looking at ways in which we can improve and enhance pensions saving, and help today's workers to enjoy a more secure later life. It is a key part of this Government's commitment to build a better Britain.

Led by my department, the review is supported by an external advisory group, co-chaired by Chris Curry (Director of the Pensions Policy Institute), Jamie Jenkins (head of pensions strategy at Standard Life) and Ruston Smith (trustee director at Peoples' Pension), to bring together experts from business and the pensions industry to help us look to the future.

The review is exploring three main themes: strengthening the evidence base around contribution levels; looking at how engagement can be improved so that employees have a stronger sense of ownership to save through their workplace pension; and examining the existing coverage of who is eligible for automatic enrolment. We intend to report to parliament before the end of 2017.

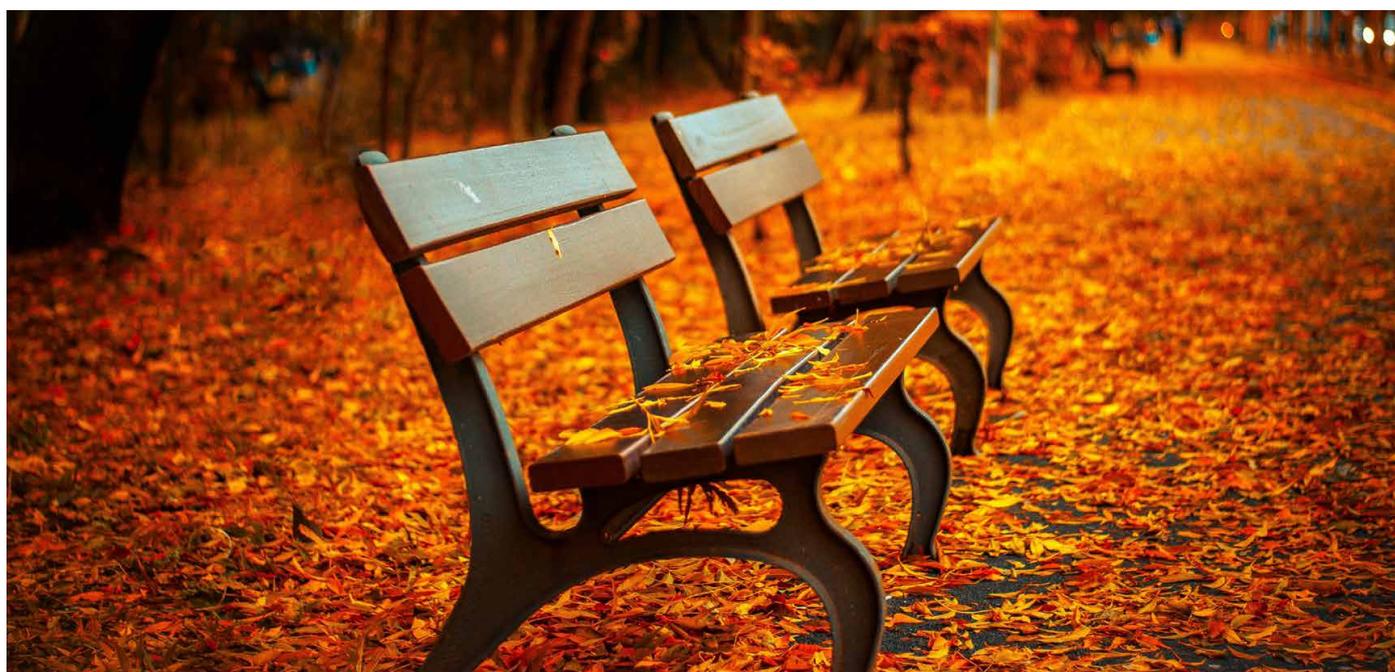
Given the millions of new savers, I also want to ensure the right help is available to support people to make the right

choices, so their hard-earned savings work for them. Earlier this year the government introduced the Financial Guidance and Claims Bill, which will create a new, single financial guidance body, bringing together the existing services provided by Pension Wise, The Pension Advisory Service and Money Advice Service. This will provide a more joined-up service of free, high-quality, impartial information and guidance on pensions and money that will help savers to make well-informed financial decisions, whenever they need it.

In the meantime, we continue to work closely with the pensions industry, which is formed of hundreds of different providers, to help businesses understand how to set up and manage a workplace pension scheme using the range of products available, and what more industry can do to keep the huge increase in new customers informed.

Automatic enrolment is genuinely changing the retirement saving habits of a whole generation for the better. While nine million people enrolled is an impressive number, there is a story, a life and a family behind each one of those people who will reap the rewards of these changes and can look forward to a more secure retirement.

There's clearly more to do to build on its success, but I am committed to automatic enrolment being a fundamental part of our aim to build a pensions system that is robust, fair and sustainable into the future. ■



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# THE INTERESTS OF THE MANY

Workplace pensions need tougher regulation to ensure the majority of savers are getting a good deal, writes **ALEX CUNNINGHAM**



*Alex Cunningham is shadow pensions minister and Labour MP for Stockton North*

THE UK NO LONGER has a system properly geared to the interests of people who invest their hard-earned cash in the expectation of a fair return and a decent pension in retirement. This is a national scandal but, to a large extent, an invisible one.

Yes, there is a great deal of satisfaction that workplace pensions are in a better place these days, due to automatic enrolment. The Labour party continues to support this policy – a policy developed by the last Labour government. And we can celebrate the very low opt-outs, though the test of sustained membership has still to come as contribution rates increase.

But if one steps back slightly, there are six glaring absences which must be remedied before we have a truly fit-for-purpose workplace pension system. And they all involve putting the saver at the centre of everything we do. The UK's pension system needs:

1. The creation of a system that always delivers a pension in retirement, rather than some additional saving;
2. Providers operating at scale to minimise costs and maximise returns;
3. Governance reformed throughout to ensure that the returns to scale go to the workers the schemes ought to represent rather than to financial intermediaries;
4. Full and clear transparency around

decision-making including the costs of investment and whether investments are sustainable;

5. The inclusion of the whole workforce, with levels of contribution to generate adequate retirement incomes for all; and
6. Workplace pensions which are realistically designed to give constant pensions regardless of stock market fluctuations.

Effectively, the workplace pension system is becoming reliant on the assumption that there will never be another stock market crash

Surveys reveal that what workers want is a reliable stream of income in retirement, in other words a pension. The workplace defined contribution system doesn't result in a pension, but provides instead a pot of savings, which workers are expected to use to negotiate the best pension deal they can. But very few people will have the combination of actuarial, economic and investment skills to do so – and we can't expect them to. Their pension providers should have a duty to either offer a high-quality pen-

sion or be required to default them to such a product provided by another operator.

And regulators should authorise only those providers that meet high quality thresholds to provide such products. It is pretty obvious that something needs to be done when even the Financial Conduct Authority (FCA) (which up to now has been a guardian of the idea that individuals can negotiate with financial institutions) recognises that retirement requires regulated defaults.

Doing something sensible is of course harder when you have a government intent on interference. It has created its own product, the lifetime ISA, that is designed to push retirement saving towards house purchases – with the side benefit that pension tax relief could be minimised and the Treasury save money.

More positively, automatic enrolment has led to the creation of large low cost master trusts. These are the future for workplace pensions though I remain concerned that the Pensions Scheme Act failed to ensure full protection for the saver in the event of a failure.

And failure is always on the cards. There is a long tail of small, single company pension schemes and the FCA concluded in its market study of asset managers that they are often incapable of negotiating low fees,



to their members' detriment. The authority will shortly be creating a cost template to capture all of the explicit and implicit costs in the investment chain to help. But if this is to succeed, fund managers must be compelled to provide the necessary data. A duty also needs to be placed on sub-scale schemes to wind up, if they cannot achieve value for money for their members.

Scale of course is not enough. Big schemes have market power and we must ensure that it is used for the benefit of those saving into the schemes, not just for the benefit of those supplying them. That is why the governance of schemes matters so much. So when we develop improvements in governance design we should act quickly to spread them across the industry.

Schemes with a fiduciary duty and trustees are bound by law to put their members first before any other interest. All schemes should be given this duty. Following pressure from the Labour party in the 2010 parliament, the Cameron government gave some ground and introduced independent governance committees. But these are neither independent nor governing and they have allowed contract-based schemes to give the impression that all is well. The FCA was supposed to have conducted a review of their function-

ing, but, disappointingly, this has been quietly dropped.

Good governance is likely to be protected where it can be scrutinised and challenged. To that end, Labour thinks that the government and regulators should hurry up and deliver the rules on the declaration of transaction costs. And legislation needs to be updated to ensure that DB schemes also have to declare transaction costs to employers and members.

But transparency goes wider than just costs and charges. Trustees ought to make it clear why they adopt the investment principles that they do. Given the long-term nature of their investing, they ought to set out whether and how they have taken into account issues which will impact on the long-term performance of the companies in which they invest, including corporate governance and climate change.

Effective transparency requires not just that a strategy is published but that trustees meet with members, present what they are doing and listen to comment. Sadly the government rejected an opportunity to compel that during the passage of the recent Pension Schemes Bill.

Automatic enrolment does not yet mean all workers have the chance to save into a pension. The changing nature of

work means that this is far from the case. As the Taylor report on modern working practices makes clear, we need to bring all workers within the automatic enrolment system, in order to avoid exclusion.

We also need to recognise that alongside ubiquitous coverage, we need a realistic level of saving to deliver meaningful pensions. Even when the maximum mandatory contributions come into force in 2019, they will be too low to deliver an adequate pension for many. The government needs to consider how to raise the contribution level above 8 per cent of qualifying earnings.

But it is critical that any mechanism deployed is gradual and sophisticated, to avoid any shocks for employees or employers. Gradual should mean a long glide-path with small but regular increases in the contribution level, and sophisticated means that any increase should be suspended in a year forecast to be one of recession.

Finally, the current workplace saving regime now primarily rests on defined contribution (DC) schemes where workers are effectively encouraged to cash in their pension pot at a specific point and buy a different retirement product. This exposes workers to a great deal of investment risk. That did not matter so much when most holders of DC products also had defined benefit (DB) pensions but it certainly will in the future as most people will be reliant on DC pensions.

Effectively, the workplace pension system is becoming reliant on the assumption that there will never be another stock market crash. This is myopic. The government ought to investigate how we move to pensions which minimise this kind of investment risk. There is already an existing model: collective defined contribution (CDC) which is established in Canada, Denmark and the Netherlands. Primary legislation has already been passed here in the UK, but the Government has not put the law into action.

Whenever an election comes, the Labour party stands ready, as a party of government, to hit the ground running and ensure a workplace pension system that is fit for purpose and that genuinely works for all. And for now, while the present government totters on, we will support ministerial, regulatory and industry moves when they deliver the agenda we believe in. ■

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# THE DEFAULT OPTION

Greater engagement in pensions will not happen,  
argue **JANETTE WEIR** and **IAIN CLACHER**,  
because of low consumer interest and understanding



*Janette Weir is managing director of research at consultancy Ignition House and Dr Iain Clacher is associate professor of accounting and finance at Leeds Business School*

**N**ICHOLAS BARR AND Peter Diamond wrote in ‘The Economics of Pensions’: “People seek to maximise their well-being not at a single point in time, but over time. Someone who saves does so not because extra consumption today has no value, but because he values extra consumption in the future more highly than extra consumption today.”

This quote sums up pension saving from the perspective of rational economics and it often feels like pension policy is set through its lens. However, our research strongly suggests that the rational view of pension saving is very far away from how ordinary people think and behave. We have spent many years talking in depth with over one thousand people about their defined contribution (DC) pensions as part of our work for regulators and providers. And our conclusion is that there is little chance of getting people to be ‘engaged’ with their pension of their own accord. This is a bold statement to make, so let’s have a look at the reasons why.

Many people simply don’t trust pensions, and it’s hard to be proactive and positive about saving into something you fundamentally just don’t like. Practically every day there is a bad news story in the mainstream media about state or defined benefit (DB) pensions, and as people don’t (or more worryingly can’t) distinguish between issues that relate to state pensions,

defined benefit and defined contribution (DC) schemes, all pensions are therefore tarnished in the minds of individuals when bad news emerges.

The manifestation of this undercurrent of mistrust came when pension freedoms allowed people to access their DC pot – and they did in droves. Some £10 billion has already been withdrawn, many people more than happy to pay a big tax bill to get the money out and under their own control, when the rational thing was to leave the money invested for their retirement.

**Auto-enrolment is a success because it plays on the equally strong human predisposition towards inertia**

*“I suppose, like a lot of people, I started to get concerned about private pension schemes. There’s been a lot of problems of late. And, you know, BHS is yet another example.”*  
**John, aged 55, still working, total encashment.**

People also tend not to engage with things that they perceive to be too difficult, and pensions are usually described as a

“minefield”. It is hard enough for people to get to grips with all the jargon, and then the rules keep changing. Even the word ‘pension’ is off-putting and confusing. To most people, a ‘pension’ is the stream of income you get in retirement, whereas the industry uses the same word to describe their savings vehicles. It is no wonder that it comes as a big shock to some to find out that their DC pension pot doesn’t automatically convert into a regular payment at retirement.

The majority of people now have a workplace pension which they didn’t take out themselves, and so they have limited personal vested interest in it. Added to that, they are saving for something that is so far out in the future it is way beyond their planning horizon, which is around 2 to 5 years at best. We observe that most people only start to have a passing interest in their DC pensions from around age 45 onwards and really start to have an active interest around six months before they want to access it.

*“Pensions are something you only take a real interest in when you get to the end.”*  
**Dave, aged 60, still working with a DC pension.**

This lack of interest in pensions is not a new phenomenon, nor is it something that is limited to DC. In the ‘DB world’ we’ve

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seen similar low levels of understanding and a lack of interest. DB pensions were seen at the time as something that ‘everybody did’ and so for many it was more by accident than design that they ended up in the fortunate position of having some guaranteed retirement income.

*“They offered the pension to me as part of the package for joining. It had nothing to*

*do with me taking the job, and quite honestly when you’re 19 and people start talking about pensions you just glaze over, and you think ‘Ha! Not interested in pensions! There’s 45 years to go! What I’m interested in is having a good time and going down the disco to get drunk’, pensions are something way off in the future. Now I’m glad I did it.”*

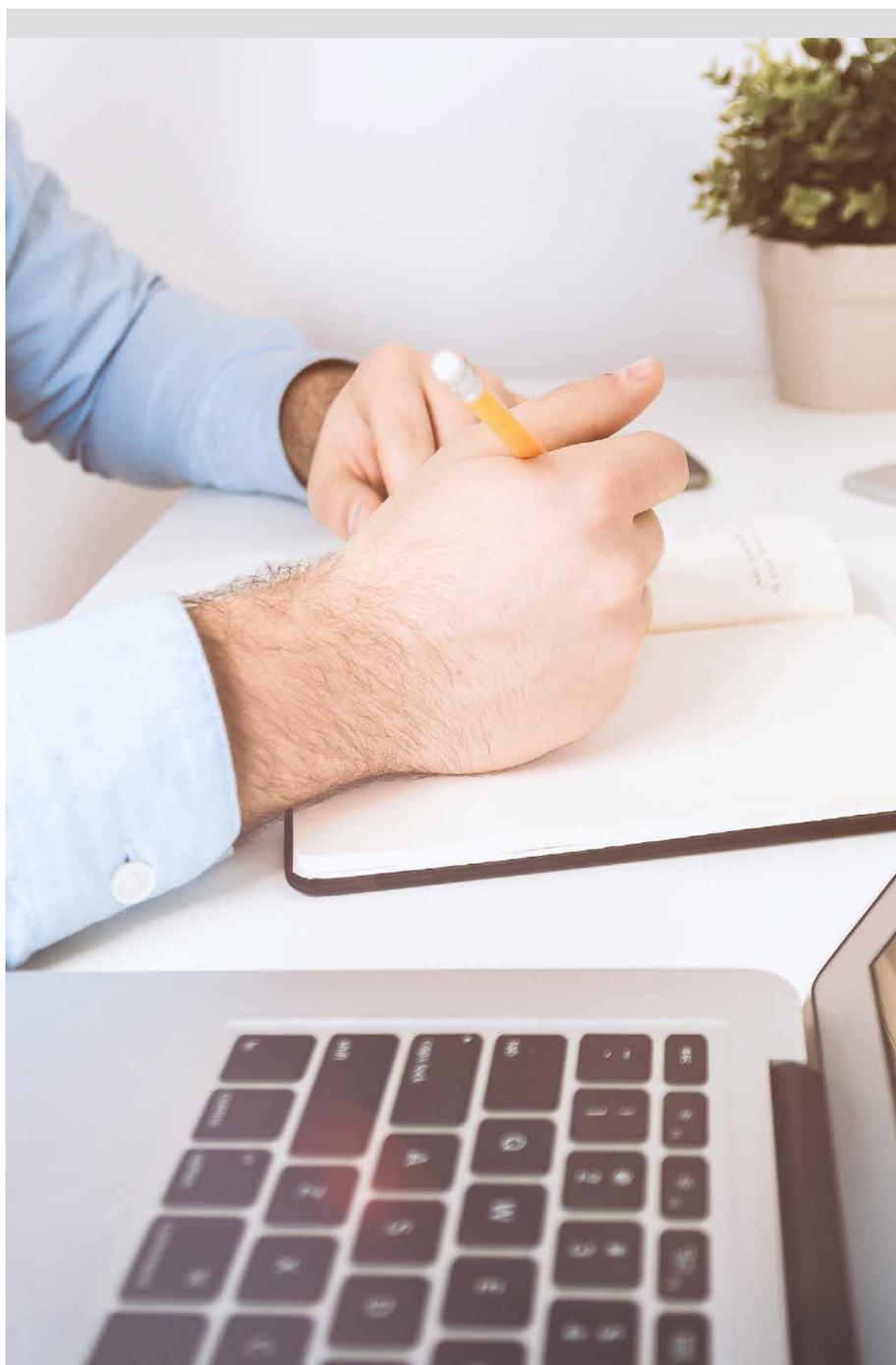
**Keith, aged 62, still working with a DB pension.**

Despite the best efforts (and millions of pounds) spent building online platforms to encourage proactive engagement, the main ‘engagement’ people have with their DC pension remains the annual statement – a communication tool which is almost designed to be ignored and filed away. It usually comes by paper through the post at a point in time that has no meaning for the pension holder other than it was the random date they joined the scheme. It is a record of what has happened in the past rather giving anything tangible about what their future could look like, and most people don’t really understand what it is telling them anyway. The framing of the information is also poor; the estimate of how much you might get as an annual retirement income shown on statements is often described as “a pittance” and makes it look like pension saving is “not worthwhile”.

In addition to all of this, we are fighting against fundamental human biases and ‘present bias’ (the desire to live for today rather than tomorrow) is one of the strongest human instincts of all. Arguably, the greatest pension policy success story of the last thirty years is the recognition that getting people to actively sign-up and contribute to their future is simply not going to work (even if the pension products have CAT standards or stakeholder caps, or whatever else). Auto-enrolment is a success because it plays on the equally strong human predisposition towards inertia, which is why we think auto-escalation, rather than engagement, is the most sensible next step to making sure people have an adequate income in retirement.

We have finally recognised the barriers to engagement with pensions in the accumulation phase and the need to nudge people towards better outcomes through auto-enrolment and auto-escalation. It therefore begs the question why on earth we think that when people suddenly hit the age of 55 they are going to change from humans who suffer from all manner of behavioural biases into rational, wealth maximising, individuals?

Based on the discussions we’ve had with real pension savers, we see that they do not. Most people spend very little time thinking about their decisions – often half a day or less in total – and are usually more engaged with how to spend their tax-free cash than how they are going to live in later life.



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Furthermore, why do we think that people can suddenly develop the skills to make a whole range of extremely complex decisions: decisions that used be made by a combination of experts?

To us, the answer is clear. They cannot. Worryingly, many of those who are so disenchanted with pensions that they have “taken control” of their money are not acting like ‘investment managers’. They put their pot into cash ISAs or high interest savings accounts (which they do trust and understand) but once the money has been parked, they are not making sure that it is working as hard as it can by shopping around for the best interest rate deals on an ongoing basis. More worrying yet, an awful lot of people who have made more complex choices than this, typically some form of flexi-access drawdown, are simply ‘hoping for the best’.

*“Sometimes it is best to be blissfully ignorant of what you should have done, try not to think too much. Do what you think is right and hope for the best.”* **Pete, aged 60, total encashment.**

Tinkering around the edges of engagement might be of some help in the future, but we have spent the last thirty years trying to achieve this Holy Grail in the accumulation phase with almost no effect. Technological advances mean that better online delivery mechanisms will be possible, and there are already pockets of excellence to build on. But even here, the anecdotal evidence is that engagement rates barely get above a third. Things might get a bit better of their own accord, as auto-enrolment drives up individual pot sizes and tips pensions into being of more interest to more people (we have observed a pot size of around £50k is a key milestone), but that will take some time.

Right now, the body of evidence we have seen from our many discussions with people making decumulation choices under the new pensions freedoms suggests that realistically only defaults and nudges will improve the paths people follow. We need to urgently leverage the power of behavioural economics to nudge people in the right direction, starting with some new social norms to replace the current preference for accessing all tax-free cash at 55.

Rules of thumb have been effective in other markets and other settings, and

more could be done to introduce simple, easy to understand statements in the UK. A revamp of annual statements to help put people in touch with their future selves is desperately needed, given how badly they do this at present. There is already some interesting work underway to look at better timings, linking to future goals, talking statements to improve understanding, and so on. However, much more work needs to be done.

Policy interventions such as a default financial health check would be extremely helpful (in the same way you are entitled to a free NHS health check when you get to 40). We firmly believe that this intervention is needed at an earlier stage, long before the money has been mentally allocated to a new car, or holiday, or kitchen. Perhaps 50 is the right age, rather than 55, well before people can access their pension. We observe that many people who are making full or partial encashment decisions between the ages of 55 and 59 have a very firm plan in mind from the outset and, therefore, do not feel the need to use Pension Wise, the government’s guidance service. Or they are using Pension Wise far too late in their decision-making journey, which makes it almost impossible to shift their perspective.

Based on our observations from the coal-face, we are also firm believers in the need for well-governed institutional default product solutions (that is default solutions run and managed by pension schemes, trustees and providers) in the decumulation space for much the same reasons they are needed in the accumulation space. Choice overload, due to the plethora of options now open to people, is just adding to engagement problems.

Some pension savers are almost begging the industry for a path to follow.

*“When you had to buy an annuity, you kind of knew there was no choice, and when you have to go down a certain route it is easier! Now, I have all this choice; do I take my money somewhere else and how do I know these are the right people? It is a bit difficult to see the wood for the trees.”* **Mandy, aged 65, still undecided after 2 years of thinking about how to access her pension.**

Disappointingly, there has been limited product innovation to date. So far NEST has published a ‘blueprint’ aiming

to start a conversation on new products, but we have not seen much else to take this challenge forward. The Future of Retirement gathered evidence from around the world on the needs of DC savers. Using this evidence base NEST proposed three building blocks to cover three phases of later life: from mid 60s to mid 70s, mid 70s to mid 80s and mid 80s and beyond. These are:

1. An income drawdown fund – to provide a steady income that aims to protect members against inflation, as well as give them full flexibility to change their mind and withdraw some or all of their money.
2. A cash lump sum fund – to be highly liquid so it can be used by members for unexpected events without impacting their core income stream. If market conditions are good in the drawdown fund then this pot can be topped up with additional lump sums. This would be a fund from which members could move money in ad hoc lump sums into their bank account to use as they like.
3. A secure later life income fund – to be ‘bought’ gradually over time through small payments from the drawdown fund. This would remain refundable up to a certain age, at which point that money is locked in to ensure a secure income is available for the remainder of a member’s life to protect against the risk of running out of money before they die.

By commissioning this work, NEST hoped that it would stimulate the innovation necessary for the market to deliver what members will need and want. But in practice there has been little innovation since freedom and choice, so it is not apparent that a market-based solution will emerge. Communications have simply not worked. If we are to improve on the current situation, more must be done using defaults and policy nudges.

We must be up for this difficult task. The window of opportunity is closing rapidly, as the next generation coming through will be much less likely to have the underpin of a DB pension, so will be mostly reliant on DC for their retirement income. The next five years is critical, and the cost of being no further forward in this area is simply too great, both for the well-being of individuals and for society as a whole. ■

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# A DECENT RETIREMENT INCOME

Without wider participation and higher savings rates, workers risk continuing insecurity when they reach retirement, argues **FRANCES O'GRADY**



*Frances O'Grady is general secretary  
of the Trades Union Congress*

**T**HE TUC IS AT the frontline of the fight for greater job security and decent wages. This includes pushing for workers to have security and a reasonable standard of living when they reach old age.

Many workers face insecurity in their working lives. More than three million workers are forced to rely on agency working, zero hours contracts and low paid self-employment. For them the flexible labour market flexes just one way. Meanwhile many in regular jobs see their wages stagnating and their terms and conditions downgraded.

Individuals are also bearing greater risk in pension saving as collective provision has dwindled. From the 1980s, many private sector employers stopped providing pensions altogether. Others switched to low quality schemes with low contributions. Workers got an effective pay cut as their pension contributions dried up. Others stopped saving altogether faced with a scandal-hit financial services industry offering complex and expensive products geared to wealthier savers.

However, pension provision is one area where some progress on offering working people greater security is being made. There has been an acceptance that individualism is a poor basis for retirement provision, the workplace must be at the heart of

pension saving and that the state has a role in nudging workers (and forcing their employers) into putting money aside. It is no coincidence that recent improvements stem from the Pensions Commission, a body with trade union and employer representation. The commission's analysis was evidence-based and it built consensus support for its recommendations.

As a result, since roll-out began in 2012, eight million people have been automatically enrolled into pensions in which their employers have to make a contribution. Few now challenge the desirability of the policy. And the vital existence of state-backed NEST as the back-stop provider for those firms and savers the mainstream industry shun is widely accepted, even by those vested interests who fought against it.

The smooth and successful introduction of recent workplace pension reforms is its great strength but also potentially its weakness. There is a risk that workplace pensions will be ticked off the government's to-do list, when the job is still only half done.

Policymakers have become distracted. Pensions freedom, which effectively allows people to cash in their pension savings from age 55, is a tax bonanza for the Treasury. But it does nothing for the bulk of workers who need a replacement wage in

retirement. New products like the Lifetime ISA give tax breaks to wealthy families but do little to help with retirement saving.

Meanwhile, low and middle earners remain at great risk of plummeting living standards in retirement.

For a start, half of adults are not automatically enrolled into workplace pensions. The £10,000 earnings trigger for enrolment means millions of low-paid workers, most of them women, are excluded. They still miss out on the pension contributions that their full-time colleagues receive even if they put together multiple jobs that combine to bring in good wages.

The self-employed are not yet included within automatic enrolment. Yet savings rates are plunging among the self-employed with barely one in four saving in a pension. And when they do manage to put money aside, it is typically a smaller amount than an employee.

Even for those who are enrolled in a pension, most employers are putting in the bare legal minimum, currently just one per cent. The contribution is based only on a portion of a worker's salary, so-called qualifying earnings, which this year lie between £5,876 and £45,000 a year. This hits low earners hardest because only a small portion of their wage is considered.



The result is that more than half of private sector employers put in less than four per cent into their workers' pensions. This is a fraction of what is needed. So, even taking into account planned increases to minimum rates due to kick in by 2019, workers have little chance of building enough savings to have a decent retirement.

And for virtually all those putting money into pensions via auto-enrolment, their future prosperity rests on the unpredictable movements of investment markets. These determine how much their savings grow during their working lives. Pensions freedom, coupled with an annuity market that is notoriously hard for savers to navigate, mean that fewer people are safeguarding their income in retirement. Therefore many will continue to be exposed to investment and inflation risks (as well as the risk of living longer than anticipated) throughout retirement. They could be faced with making complex and important decisions at an age when they might reasonably expect to be more concerned with grandchildren than high-growth stocks.

These challenges can be obscured by a public debate that too often regards pensions as a pensioners' issue, not one for workers. The result is frequently a divisive and sterile discussion about intergenerational conflict. As if taking pensioners' TV licences would help young workers trying to save while paying the rent and surviving an often hostile jobs market.

To build on existing reforms, we require a far greater understanding of how much people need to have a good standard of living in retirement. This will have to take account of developments such as rising

numbers of private renters and growing care costs.

And then we need a long-term plan for how we are going to ensure they get it. This will undoubtedly require an acceptance that the state pension is not some undeserved perk for today's pensioners (millions of whom remain in poverty). Rather a decent state pension is going to be vital to today's workers when they get to their later years. We should also recognise the value of those defined benefit schemes that remain in the private sector delivering a secure income when workers reach

**These challenges can be obscured by a public debate that too often regards pensions as a pensioners' issue, not one for workers**

retirement. Every effort should be made to ensure that those that remain open to new workers continue to be so.

For workplace pensions, the government's ongoing review of automatic enrolment provides an opportunity for some quick wins. It is time to abolish the earnings trigger and qualifying earnings. Start employer contributions from the first pound of earnings. Many good employers already do this. This would simplify administration for businesses, bring many more workers into the system and boost savings levels.

We must ensure that the self-employed, many of whom are low-paid, are also

brought into the scope of auto-enrolment. For example, the recent Taylor review floats the idea of effectively auto-enrolling self-employed workers and administering it through the self-assessment tax process. He suggested that this could be supplemented by a government top-up.

The auto-enrolment review should set a route map for bringing contributions up to reasonable levels. It is nearly 16 years since the establishment of the Pensions Commission. Some say we need to wait until automatic enrolment is fully implemented. We say that there have been enough delays. Changes might not be made overnight. But we have to know the end destination. That way contribution rises can be factored into negotiations over pay and conditions and into long-term business planning.

Most analysis suggests that total contributions should amount to 12 to 16 per cent of earnings. But more work has to be done to understand people's needs in retirement to ensure that public policy is encouraging savings at the right level. For example, the rise of private renting could lead to retirees facing higher housing costs than in the past.

We should also see how those contributions could be made to go further. We could recognise the benefits of scale that defined benefit schemes deliver and replicate it in the defined contribution world. The introduction of large-scale collective defined contribution schemes has the potential to cut costs and allow risks to be shared more effectively by collective schemes. Parliament has already passed a law allowing them. We are just waiting for regulations setting out the small print.

And when it comes to looking at 'how to spend it' options for retirement itself, we should learn some of the lessons of recent years. Auto-enrolment works so well for consumers because it makes it easy to save, not because savers have fallen in love with pensions or we created a nation of wannabe fund managers. We must make generating an income in retirement as easy as saving it with robust, well-researched, good value, properly governed default options.

The fight for a decent pension is part of the fight against insecure work. We have made progress. But we must see reform through if we are to ensure that all workers have the chance of a good standard of living in retirement. ■

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# A LONG-TERM BUSINESS VIEW

Businesses have adapted to recent workplace pension reforms and made them a success. Going forward, they want to see more long-term policy development, writes **NEIL CARBERRY**



*Neil Carberry is managing director of people and infrastructure at the CBI and a member of the government's auto-enrolment review advisory group*

IT IS HARDLY surprising that even the keenest followers of the financial pages have struggled to keep pace with changes in pensions policy in recent years. Successive reforms, from a new state pension to automatic enrolment of staff into workplace schemes, have remade our system, while the regulation, funding and governance challenges of defined benefit schemes are never far from the news.

Today, a majority of workers are automatically enrolled into pensions – but we also retain the value of many firms doing more than this, as they provide pensions that go well beyond the statutory minima. Firms are contributing billions every year to support stable retirements. And 96 per cent of business leaders see a strong business case for providing a workplace pension, demonstrating the level of commitment across the board.

That is undoubtedly good news. And it really matters. There are only two ways of delivering low-cost, high-scale retirement saving to the whole population: government schemes and business provision. Our system is rightly a mix of the two. This fact is often overlooked – but with government already facing significant fiscal stretch as longevity increases – the role that UK employers have always played needs to be supported and enhanced,

especially when they are doing more than the law requires.

Sadly, that is not always the case. With the honourable exception of the apolitical and multi-government roll-out of automatic enrolment, too much change in pensions over the years has been done with short-term government goals in mind, not long-term pensions ones. In recent years, politicians of all political hues have raised contribution holidays from defined benefit schemes in the 1980s and 1990s as an issue when discussing these schemes with the CBI – often unaware that these were a direct result of short-sighted government tax policy at the time. That is just one example; others include the removal of the dividend tax credit in 1997, which damaged funds' investment returns, and the 1995 Pensions Act that set up a system which ultimately led to the creation of the Pensions Protection Fund (PPF) in 2004–5 by introducing the inadequate minimum funding requirement and a somewhat toothless regulator.

So if businesses want one thing from workplace reform, it would be this: a stable, long-term partnership to deliver high quality pensions, not a cycle of policy change. And a focus from key departments on talking to employers themselves, not only financial services firms – who do have a vital role to play, when making policy –

but the employers are key. That will help to end the sense in business that those firms who do more than they are asked to are just signing up for more pain than those who stick to the statutory expectations.

What might a new partnership look like? Let me set out a few key points.

For workplace pensions to be sustainable over the long term, the primary test is that businesses need to be able to grow while also meeting their commitments to staff. Central to this is a stable framework of regulation, incentives and governance, so that employers who are doing the right thing can support their schemes.

First, where firms have defined benefit schemes, the challenge of honouring their pension commitments whilst remaining competitive can be a difficult one. The cost of providing defined benefit pensions has risen substantially, driven by higher-than-expected life expectancies, market factors, and sometimes, regulatory change. Despite the cost of these legacy schemes, businesses' ongoing commitment is demonstrated by the £20.3bn paid into defined benefit pensions by UK employers last year.

It is only right, then, that government takes a balanced approach to regulation, to support firms who are standing by their promises to remain in good health so that



they can meet these costs. The coalition was right to set this on a statutory footing in a new requirement on the Pensions Regulator. This should always stand alongside effective protection for members where employers cannot or, in a small minority of cases, will not, continue to provide adequate funding for schemes. Businesses believe that the regulatory framework is in place to achieve this and support strong enforcement where necessary. After all, it is companies themselves who pay the costs of the PPF when things go wrong.

The case-by-case system ensures that the Pensions Regulator effectively identifies and engages with employers who might encounter difficulty in meeting the costs of their schemes. If greater powers are needed for the regulator, businesses are ready to discuss this – but these changes need to be well-structured. More intervention in corporate transactions may slow decisions and turnarounds, with a negative effect on growth and jobs as well as on schemes, so we must proceed with care.

It should be a cause of concern for government that firms are already having to invest less in their business and staff because of defined benefit costs. The Resolution Foundation has found that money set aside to cover increased deficit payments has led to lower levels of pay for workers of around £2bn. It is likely to have had a similar effect – in many key sectors – on investment, something which regular CBI pensions surveys suggest. The political debate has often focussed on whether funding is high enough. But this needs to be set in the context of defined benefit funding being based on volatile multi-decade estimates, while pay and

business investment decisions are in the here and now. On balance, expectations today are fair, and demands for higher funding may be self-defeating as they weaken the best security all defined benefit members have: a solid employer standing behind the scheme.

The second issue is getting automatic enrolment and defined contribution pensions right. Given the scale of defined benefit promises, and hugely rising longevity, most firms have moved to defined contribution schemes in recent decades as these give firms clarity on what they must pay in. It is no surprise that these are also the vehicle that has been chosen for automatic enrolment.

So far, the government's significant intervention – introducing automatic enrolment – has been a success. And it must be said, employers have risen to the challenge. By 2018, it is thought that 10 million workers will be saving privately for the first time or saving more as a result. The success of automatic enrolment is underpinned by employers' high compliance rate: last year, even amongst the first group of small and micro employers to enrol, compliance rates topped 95 per cent.

But, with minimum contributions for all employers due to rise three-fold over the next two years, automatic enrolment is likely to be more trying over the next few years, especially when set alongside rises

### The success of automatic enrolment is underpinned by employers' high compliance rate

in the national living wage – particularly for small firms – and the apprenticeship levy's effects on medium-size firms. That is why we need to remember its purpose – a basic level of saving for all, alongside a new state pension – and avoid siren calls to further ramp up contributions. The aim was always to have a universal system that all employers can afford – and room, for those who can, to do more – not to create a single national pension approach which diverts funds to pensions from pay, job creation and investment in a way that is more damaging in the long run. Average employer contributions are 7 per cent of

earnings, according to our survey data, far beyond the current minimum.

Equally important, upcoming increases in contributions will have an impact on the numbers of employees opting out of automatic enrolment – a key indicator of the policy's continued success. As take-home pay reduces as employees' own pension contribution is increased, some workers may necessarily sacrifice retirement saving to cover everyday living costs. As such, businesses are clear that the underlying principle of automatic enrolment – to provide a basic level of income that people can add to when they can afford to – should remain intact. Higher contribution rates may mean those who are most likely to need to save feeling they should pull out. This is not a policy that needs radical change in the short term.

Third, the incentives in the system need to remain stable. Maintaining continuity around pensions is key to improving engagement amongst savers. A crucial element of this is tax relief for employers who choose to do more. Businesses' ability to claim national insurance relief on pensions contributions is essential to the partnership approach and should never be put into question. And for individual savers, the existing model and rates of relief offers an effective incentive. Moving towards a flat rate of relief could make pensions a less attractive saving method. In fact, our survey has found that 59 per cent of firms believe that their employees would level down their contributions if a flat rate of relief was introduced.

Businesses have long demonstrated their commitment to seeing through their pensions promises, on automatic enrolment and in their own long-running defined benefit and defined contribution schemes. These have left Britain with more funded pension saving than any other country in Europe. And confidence in the system is high – Britons now expect 32 per cent of their income in retirement to come from workplace savings, according to The Aegon retirement readiness survey 2017.

The goal now is to preserve this – and to support businesses to do more. That is about stability, predictability and a structure that helps firms succeed, invest, pay their staff well and offer good pensions. More long-term thinking and a new partnership with government is required, but there is a solid base to build on. ■

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# GOVERNANCE MATTERS

A new governance mechanism is needed to protect consumers in the changing pensions market, writes **JEANNIE DRAKE**



*Baroness Drake is a Labour peer and was a member of the 2003–2005 Pensions Commission*

**A**UTOMATIC ENROLMENT HAS been a compelling behavioural intervention. It has harnessed inertia for the public good and got millions to start saving or save more. By March 2017 almost 7.7 million people had been enrolled by 500,000 employers and the largest impact has been on groups for whom coverage was lower before the reform, including low earners and young workers. Some 85 per cent of those actively saving are contributing into a defined contribution scheme.

But the introduction of automatic enrolment, in a UK pensions market with low barriers to entry, has resulted in a significant increase in the number of contract and trust based providers. And this raises concerns about sustainability, governance and value for money. The last five years has seen a stream of consultations, reviews, new legislation and regulation, as the government has sought to protect the consumer's interest.

However, governance models have not yet evolved sufficiently to address the challenges which the current application of auto enrolment (not the idea itself) has exposed. Administration, conflicts of interest, complexity, value for money, advice, guidance, mis-selling and scams are just some of the issues government and regulators are seeking to address, often adding more complexity. Action has been taken by government

to protect the consumer. But how effective have the measures taken to date been and what more needs to be done?

In recent years ministers and regulators have sought to introduce tougher governance requirements for trust-based and contract-based DC pensions. But improving governance is complicated by the existence of two regulatory regimes. The

**However, governance models have not yet evolved sufficiently to address the challenges which the current application of auto enrolment (not the idea itself) has exposed**

Pensions Regulator (TPR) deals with trust-based provision and the Financial Conduct Authority (FCA) with contract provision, with different legal duties attached to the people running pension schemes. With a trust, their legal responsibility is to act in the best interest of the scheme's beneficiaries. In contract provision, their ultimate legal responsibility is to shareholders. At its most fundamental, independent trustees

can sack their provider and/or administrator if it is in the interest of the members. The board of an insurance company would have to sack itself.

A contract-based provider has to observe FCA principles but they permit the provider to prioritise shareholder interests. A provider is only in breach of the principles when it strikes the wrong balance of interest between scheme savers and shareholders. By contrast, a trustee cannot allow any conflict with the primary interest of serving the beneficiaries and any breach of trust creates a legal liability to the members of the scheme. This difference in clarity of obligation results in different incentives.

Meanwhile 'master trusts', multi-employer workplace pension schemes, have grown rapidly from 200,000 members in 2010 to more than 7 million by 2016 and are anticipated to rise even further. Until now they have been inadequately regulated. Low barriers allowed market entrants to operate on minimal requirements, with members' savings bearing the unlimited risk of scheme failure. Some members were exposed to regulatory arbitrage when a scheme founder introduced a profit motive into the master trust, limiting the powers and independence of the trustees. There was a compelling need for the Pension Schemes Act 2017 which gave

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substantial powers to the secretary of state and TPR to subject master trusts to a new authorisation, supervision and wind-up regime – although the extent of its rigour will only become evident over time.

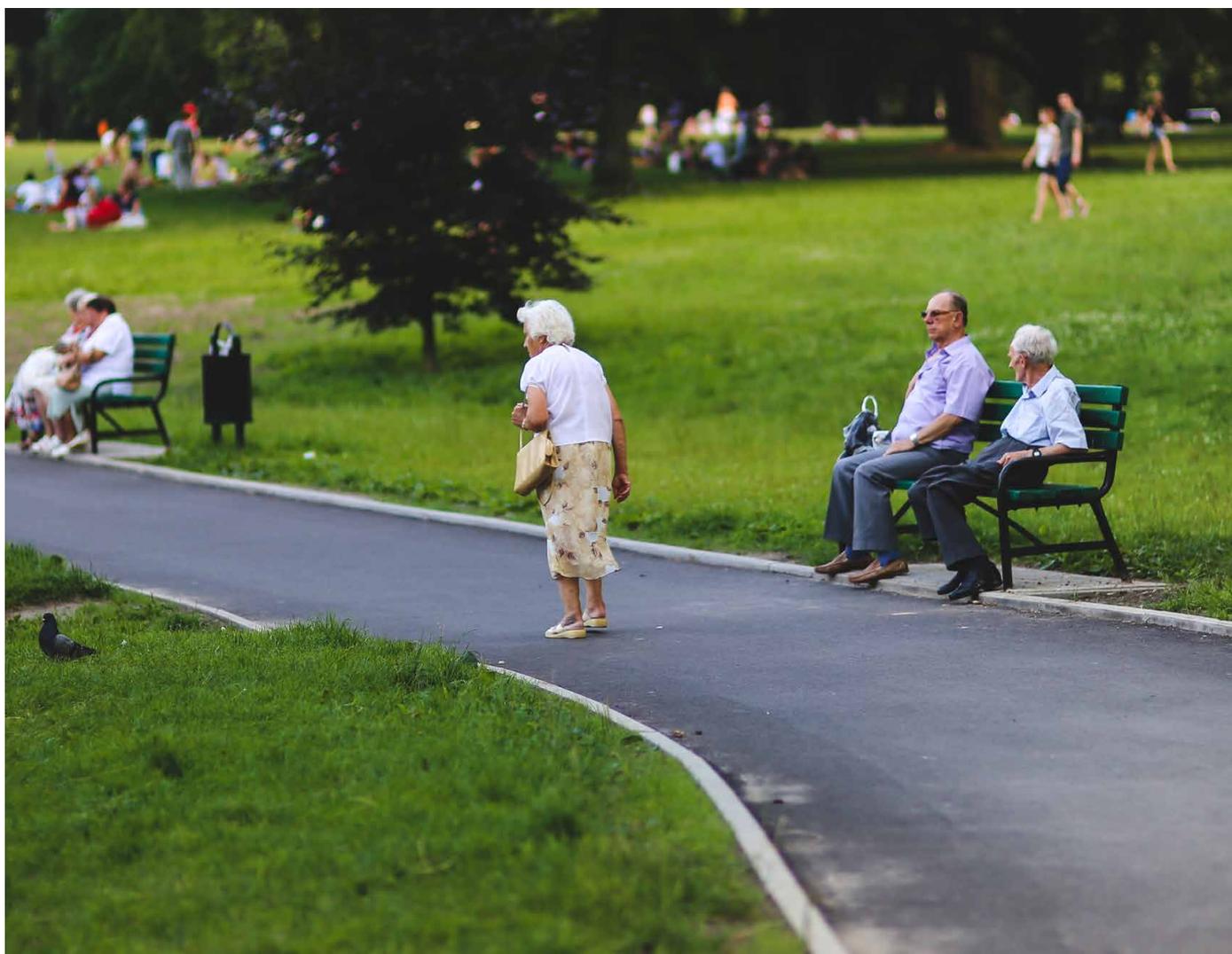
Existing and future master trusts will need prior authorisation to both enter and continue operating in the market. As Nicola Parish, executive director at TPR observed in January “in a dramatic departure from the way that any other type of pension scheme is established, no master trust will be able to open for business without our prior approval. This will substantially improve consumer protection in this section of the pensions market”. It is anticipated that TPR will drive consolidation by withholding authorisation from poorly governed trusts and by encouraging small employer sponsored schemes to

consolidate into master trusts, when they cannot achieve value for money.

On the contract side of the market, however, scheme members lack any direct agent to represent their interests. The FCA now requires providers to set up independent governance committees (IGCs) to represent members’ interests in assessing value for money and recommending changes where necessary. IGCs have a fiduciary duty to act solely in the interests of scheme members but their effectiveness is neither fully developed nor evaluated. They can make recommendations but these are not binding. They also create potential for conflicts of interest as the provider appoints and funds the members of the IGC, who can include their employees and people drawn from organisations which supply them with services.

The FCA have deferred their full review of IGCs in a stated desire to concentrate on priorities including the functioning of the asset management market. This is a concern given that the Office of Fair Trading’s recommendation to create IGCs flowed from the conclusion in its 2013 report on DC workplace pensions that “competition cannot be relied upon to ensure value for money for savers in the DC workplace pensions market”.

Securing value for money for pension savers is still work in progress. A 2016 FCA consultation paper proposed rules to improve cost disclosure, considering this essential to “enable the flow of information to the governance bodies of those schemes”. Then, in November 2016 it published its asset management market study interim report, a hard-hitting critique of the “sus-



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tained, high profits” that the industry had earned from savers and pension funds over the years. The FCA considered introducing a fiduciary requirement to act in the best interests of investors but it is now proposing a more restrained adjustment to existing fund manager governance arrangements.

The FCA has recently published welcome new rules, to take effect from 3 January 2018, requiring firms to provide information about transaction costs and administration charges to the governance bodies of DC workplace pension schemes. It will be important to monitor the effectiveness of those rule changes in delivering real transparency on costs and value to the member.

TPR oversees trustees’ discharge of their fiduciary duties, while the FCA oversees the delivery of well-functioning markets. Their remits result in the different governance regimes. But it is highly questionable whether it is ever possible to achieve a well-functioning market in contract based pensions, because workplace pension provision is not a normal market. Automatic enrolment harnesses inertia for those savers who do not engage. This raises the bar on the governance requirement, since passive consumers cannot exert the normal or necessary force on a shareholder-owned company to align interests.

In January 2014 Lord Turner said of the pension market: “It is a system absolutely shot through with market failure where the process of trying to provide in a competitive fashion simply does not work well.” This echoes the view of the OFT’s 2013 report on workplace pensions which stated that the sector had amongst the weakest ‘buy-sides’ they had ever encountered.

The complexity of pensions, their long-term characteristic, the presence of passive consumers saving by inertia and a market which cannot align incentives all means that another governance mechanism is needed. The answer is a fiduciary duty as required under trust-based governance – and where there is a conflict, the primacy of consumer interests above shareholder interests needs to prevail.

That is not to deny that inefficiencies can manifest in trust schemes. The early experience of master trusts exposed problems. And some small DC trust schemes lack the capacity to deliver value for the member, although this is usually because of an absence of scale rather than flaws in the fiduciary rule. But TPR has new powers

vis-à-vis master trusts and it is raising the standard required of trustees responsible for an employer based scheme. It is also placing increased emphasis on enforcement.

Reforms to policy and governance to protect consumers when they are saving are not being replicated when it comes to retirement decisions. The terms of reference of the current review of automatic enrolment only look at saving and exclude the drawing down of pensions. In the saving phase the inability of individuals to make optimal decisions in the face of complexity is recognised and regulated defaults have been introduced. In the drawdown phase policy assumes behaviours to be dramatically different, with individuals directly bearing responsibility for making optimal choices.

The radical ‘freedom and choice’ reforms of 2014, which gave people full access to their pension savings, have introduced new risks attached to individual decision-making. As the FCA observed in its retirement market study interim report, consumers are poorly placed to drive effective competition. Greater choice and potentially more complex products will reduce consumer confidence and weaken the competitive pressures on providers to offer good value.

Information and guidance both have an important role to play but individuals who exercise their ‘freedom and choice’ are vulnerable to behavioural biases and public policy has not yet reacted sufficiently to as-

### A private pension system needs to support individuals to both save and secure an income during retirement

sist them to make good decisions. Inertia is extremely hard to disrupt and even when individuals do engage ‘good’ outcomes and behaviours remain hard to achieve.

Options need to be configured to reflect that humans are not perfectly rational. Without a set of default products at retirement, subject to robust governance and charge caps, many individual savers will make sub-optimal decisions. Today, income drawdown products do not have the governance and value for money

requirements of workplace pensions. A private pension system needs to support individuals to both save and secure an income during retirement. Without both elements, defined contribution automatic enrolment schemes are a long-term saving product rather than a pension.

A new approach to regulation and governance also needs to reflect that going forward many people will have several pension pots. Automatic enrolment places a direct responsibility on government to ensure that they all offer value for money, through addressing a series of interconnected issues which include the management of small pension pots, charge caps and transparency of costs and charges.

Small pots of savings are increasing as workers change jobs (on average 11 times over a working life) and they are at risk of incurring higher charges and getting lost. The government’s initial solution was for small pots to follow members to their next workplace scheme. But this approach has been mothballed as ministers look increasingly to the pensions ‘dashboard’ for a solution. This is a digital interface where individuals can view all the information on their state and private savings, which had been being developed by providers under the auspices of the Treasury. The dashboard has considerable potential to improve transparency and accessibility and empower savers but it comes with a huge governance challenge. It requires near-universal coverage of millions of people and their relevant data and robust consumer protection.

For this reason, there needs to be a public service dashboard available – a safe place to view savings and pensions, where consumers are not faced with aggressive marketing or scammers. Important issues of identity verification, data matching and pension-finding consent need to be policed and oversight needs to be rooted in a public service body. There is also a need to understand how savers can be nudged into using the ‘pension dashboard’ if its full potential is to be realised.

All in all, we need a much stronger framework for pensions governance. It is needed when people draw down their pension savings, not just when they save. And all DC pension schemes need governance requirements that place the interests of savers first, building on the fiduciary principle. ■



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**Bright Blue** is an independent think tank and pressure group for liberal conservatism. Its work is guided by five research themes: social reform, immigration and integration, energy and environment, an ageing society, and human rights. As a community of liberal conservatives, Bright Blue is at the forefront of thinking on the centre-right of politics.



**The Fabian Society** is Britain's oldest political think tank. Founded in 1884, the society is at the forefront of developing political ideas and public policy on the left. The society is alone among think tanks in being a democratically-constituted membership organisation and was one of the original founders of the Labour party.

**This report represents not the collective views of the organisations involved but only the views of the individual authors.**