Broadstone

Consultation Response

Pensions Investment Review: Unlocking the UK pensions market for growth.

January 2025

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Executive Summary

We are pleased to be able to provide our thoughts consultation on unlocking the UK pensions market for growth.

Broadstone are a firm of consultants and actuaries that advise trustee boards of defined benefit and defined contribution schemes. We also support employers when establishing their own pension schemes to comply with auto-enrolment requirements and wide employee benefit structures. We also provide administration and governance services to two multi-employer master trust DC schemes. It is from that perspective we respond to the consultation.

We agree with some of the premise for the government's work. If you started from a blank piece of paper, you probably wouldn't create a pension system across two regulatory regimes and so many providers. This view is beyond even the policy aim of increased investment in a particular asset class. It is across employer, adviser and of course saver experience.

However, the focus on productive finance needs to be framed as a clear benefit for members – and the evidence is not clear that this will be good for members. GAD's own modelling only indicates marginal benefit. This also requires clarity on what asset classes the government wants to see more investment in.

Our view is that the VFM work in train should be the focus to provide a framework for consistent good outcomes for members. Forcing change is going to be hard to achieve and will bring lots of disruption and cost into the market.

We would like more focus on how the goal would be achieved by fewer schemes. Why is a scheme of £2bn AUM or £10bn so much worse than £25bn? Why is it more or less likely to invest in productive finance. Our belief is that the focus should be on creating products that are compelling for investment via:

- Tax breaks – the government could consider reversing the dividend taxation by re-introducing tax credits or cutting/reducing stamp duty for pension schemes.
- First loss protection or other downside protection – whereby the government is co-investor/guarantor so should an asset underperform then the government takes some of the downside hit.
- Low cost i.e. as low cost as possible to avoid erosion of value – we appreciate that the value discussion must be had because private market investment comes with higher fees. The government could assist in creating opportunities for investment that have as low cost as possible. We know that members/savers have been well served by the transition from active management to passive management and this is a difficult step for trustees and providers to take back towards active management and the inevitable increase in charges, The government may have to consider some subsidy or greater focus on fees from the managers to ensure that the value discussion can be argued from costs as well as investment return subsidy or working with managers to reduce cost as much as possible.
- Clear societal value – to increase demand for UK private markets the government could consider doing this in a similar way to ESG has been introduced into portfolios. If members and trustees can be aligned to understand the benefit to the society that we all live in, then this may increase flows. Albeit this would be a slower transition.

In summary the government should spend some time considering a product that is low costs, does provide the benefit to the economy we need and protects savers from disastrous downsides

Short summary of our responses:

- Some concern that £25bn is too large and feels arbitrary with little evidence to support it will lead to the allocations to private markets that are needed. Is not a £10bn scheme large enough, or £1bn? It also fails to recognise the level of asset pooling that already happens across the market.
- Size limit could have a negative impact on innovation and new entrants. Disruptive pension providers capitalise on the sluggish innovation seen in larger providers. This can be seen across industries not just pensions. Having size limits will limit choice and developments in the future and the government should consider this longer-term downside.
- Regulate consultants – regulation of advisers and consultants working with employers to set their pensions strategy will enable the introduce of standards of operation and ensure employers are getting whole of market support to choose the right provider for them. We look forward to working with the regulators on establishing this framework.
- Employers given statutory duty ensures that the key stakeholder is invested in their schemes and must demonstrate compliance. We have concerns around the sizes of employers to whom this should apply but we think in principle this will lead to good outcomes for members.
- Master trust direction of travel interesting but is this contradictory to employer responsibility and proposals for their statutory duties – many see that a move to Master Trust absolves the employer of oversight already – but is it the right way.
- A lower number of providers could benefit all, but a careful balance to not upset a competitive market that the end user (members) benefit from. The consultation states that consolidation is happening, but the government's own statistics show a 32% drop in the number of DC schemes since 2020. We need to ensure that the speed of change being pursued is ultimately of benefit to members, not just those seeking wider investments from pensions. There is a strong argument that the consolidation from the small schemes into the large will happen and accelerate with the introduction of the VFM requirements. The government could consider leaving the market to develop as it will into fewer larger schemes organically and focus on the supply of good quality UK private market products, as per our observations above.

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Responses

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

We believe that some clarity is still required to distinguish between 'default arrangements' and 'default funds. We do not understand the comment in the consultation that restricting the number of 'default' funds will not necessarily reduce the number of 'default arrangements. If providers are restricted in the number of 'default funds' offered, employers (and members) will have less flexibility to choose different/tailored 'default arrangements.

We agree that the disparity of default funds appears hard to justify from a standing start. It is clear that these have developed overtime due to developments in the market. Limiting the number of default funds would appear a useful rationalisation of the market. However, having a number of defaults to aim for could have unintended consequences.

- Members benefits from default fund strategies targeted at their needs – would this be compromised?
- Restricting as far as one default could be too broad brush an approach. It could encourage providers to target a particular (profitable) market segment over others. This could distort the market and leave less commercially attractive employers and staff missing out.
- Would there be an exemption to cover those with religious beliefs e.g. Shariah funds?

We also note in this response a few times that the work already in train to improve VFM in DC schemes could see this happen organically and as already mentioned we are a supporter of this method of change.

This could also conflict with work also underway to bring accumulation and decumulation phases together as default pathways and strategies could be targeting different outcomes e.g. drawdown or annuity. The reduction in flexibility here could be detrimental.

Question 2: The proposed approach at default fund level could mean that the number of default arrangements would remain unchanged. Will imposing the requirement at this level have any impacts on the diversity of investments or the pricing offered to employers?

As above, we are not clear how restricting the number of default funds will not lead to a contraction in the number of default arrangements.

Also, 'pricing' offered by providers is not just a function of the investment strategy, a large component is the wider service offering. Some proposals are needed with regard to clarifying what the requirement is to common pricing – is it the 'price' of the fund (for investment management only) or does it include servicing costs too (administration, communication, etc.).

Our understanding is that the proposed approach is to set a minimum size of AUM will cause disruption to the market. Ultimately this could reduce the ability of providers to invest as per the policy aim and in addition introduce new costs and complexity into the system. It also isn't clear for how long there will be this disruption as smaller schemes get acquired by larger and other schemes merge. One key issue will be the lack of visibility for employers or trustees looking to move to another provider without understand the future destination of that scheme.

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

A minimum size is hard to estimate. While a minimum size could be optimal, we would suggest some analysis is done on the minimum appropriate size.

£25bn as a minimum does seem too large unless the aim is for fewer schemes. If the government wants fewer providers in the market, then we would agree that this is appropriate – provided the government understands the downside of having £25bn minimum funds will have. As a barrier to innovation and new players in the market this will be significant. There runs the risk of a review in 2040 of a stagnant and bloated pension market concentrated in a few providers making £ms in fees from all our pensions. Is this what the government wants?

We're getting close to not seeing the wood for the trees. If the government's aim is for greater allocations to productive finance, then the supply side should be the focus. Create the funds that are compelling for investment. The focus on shrinking the providers on the understanding that those few will be easier to regulate/influence and have the capital to invest seems the hardest way to achieve the aim.

We think there are excellent funds with sub £1bn AUM. The government is already on a path of consolidation via a levelling up of standards via VFM. We believe this work already in progress will achieve a great many of the benefits for savers and the government's economic goals.

The government seems to be overlooking the pooling that already exists among providers across the size spectrum.

Question 4: Are any other flexibilities or conditions needed regarding the minimum size of AUM (for example, should it be disapplied in circumstances at regulators discretion for example to enable an innovator to provide competitive challenge in the market or be disapplied in case of a market shock or another specified circumstance)?

New innovators should be given time to accumulate any minimum AUM to operate. It should also be reviewed as a relative target once established.

We are concerned that there will be regulatory pressure to complete transfers by a certain date and this should be avoided. Albeit we appreciate an end date should be set but this needs to accept the pressure on completion of complex deals.

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

We are concerned about the level of market disruption as c60 providers work their way down to c6. This level of market disruption should not be rushed due to risks on members and needs to be carefully managed, if implemented as presented. The regulators may need to be given powers of oversight for schemes that a reluctant to merge with other providers. In addition, the tactics of those looking to acquire business at a fair value but with the backing of government and regulatory intervention needs to be carefully considered. We are concerned about the way these providers will work through this charge. In addition, providers unattractive to M&A may end up "on the shelf" as it were and so we would assume NEST will become the consolidator of last resort. The government may consider other providers as a panel of "last resort."

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

We would expect a target of 2030 to be optimistic, given we are at consultation stage in early 2025. To ensure the smooth transition of assets and services to new providers (and a shrinking number of new providers) the simple number of people required to appropriately undertake this work in a low-risk manner is unlikely. We've seen similar issues in the DB space as simply the number of consultants and administrators able to work through the issues.

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

Schemes that have become pseudo-Master Trusts by the nature of their company's structure (e.g. in the religious sector and sports sectors) these provide excellent VFM for their staff and are of viable size but yet this proposal does not warrant their structure being ripped up. We think an exemption should be created for such arrangements.

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

As noted above we are concerned about a few big providers cornering the market and a steady race to a vanilla pension experience for all. Other systemic risk is central to the proposal of lack of diversification if all funds begin to look and perform the same any economic shocks will have an unhedged and detrimental impact on outcomes for savers.

We are concerned that size becomes the arbiter of good. This should be paused on and considered as a downside of this drive towards size. In addition, the concurrent desire for other small trusts to consolidate could result in that work pausing as focus is on this larger exercise to consolidate the bigger providers. Trustees may not want to take plunge without clarity of the long-term direction of the new provider. Trustees can be very paternalistic and while transferring their members to a new provider can be confusing for members for that provider to that be merged into another shortly thereafter can lead to embarrassment for the original trustees.

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

We agree any approach should ne nuanced. On the area of CDC Successive governments have put a lot of work into creating a legislative and regulatory framework to all single and ultimately multi-employer CDC arrangements. To then hamstring their creation by including them in the wider DC consolidation reforms would be nonsensical. If the government truly thinks that CDC is a good idea and a benefit and improvement to the pensions system that it should exempt them from these requirements.

CDC schemes by their design will also support the aims of the policy and if implemented successfully could grow rapidly. The long-term nature of their design lends itself to infrastructure and projects the government would favour investment.

The government should set out a monitoring methodology for the growth of CDC and comment as this develops in the coming decade.

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

Accelerating the process will be optimistic and potentially introducing risk unnecessarily.

As noted elsewhere the policy aim is greater allocation to private markets – focus on the incentives to allocate to that asset class will help.

Resourcing is the key challenge and ensuring regulators can properly oversee this process.

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

A single price regime should be avoided. Differential pricing reflects the nature of the client and provider. This can be influenced by number of members, turnover of members, size of contributions, ancillary services around guidance and communications, level of bespoke statements, employer engagement and even the levies which schemes will pay.

Single pricing may also see unjustified and unwelcome price increases on member funds.

One option would be to regulate for a single price for the 'fund' but allow differential pricing for the support services offered.

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

We are supportive of allowing transfers without consent where a number of criteria have been established. The government should consider the VFM framework as starting point to ensure that savers are not being transferred into a poorer arrangement. However, this does run the risk to the government's aim as it has not been demonstrated that larger is better that the receiving scheme may have to work harder to demonstrate they will be able to provide a comparable/better service and return than the ceding scheme.

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

Yes, IGCs should be used. Whether an established expectation can be created via work with regulators to ensure standards are recognised. There can then follow a clearance/approval process with regulators. Whether this could be achieved more efficiently with clear guidance should be considered, noting points above about regulatory resources.

IGCs should be able to demonstrate their independence from the providers – whether this be via external advice or declaration from the Chair.

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

Here we believe that the member should be central in the decision-making process. Conflicts of interest on the IGC would need to be clearly managed and thought will be needed on how best to achieve this.

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

Active schemes – employers should be given the requirement to consider an alternate provider. In addition, where members are still employed the employer will be helpful in communicating change and the reason for change. For "legacy" arrangement the employer should not be involved.

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

Yes. If the employer is to be involved, as suggested in question 15, then some written confirmation should be a requirement.

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

As noted above – VFM standards should be assessed. Independent advice should be provided in line with regulatory guidance/approval. The existing regulations around 'trust to trust bulk transfers' might be a starting point for a suitable framework.'

Care should be taken to ensure that complications with protected pension ages and/or guaranteed annuity rates and/or with profits funds are understood and protected.

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

There are a number of issues.

- Historic data quality and provider systems shortcomings
- How costs are to be met
- Disruption to savers near retirement
- Tax relief differences

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

We think if the system manages conflicts of interest, saver protection, independence and regulatory oversight consumers should be protected. No one can guarantee that there will be no issues for members, but these can be minimised via the actions discussed.

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

Where savers have made a choice to invest, and this will be disrupted they should be consulted and given the option to opt out.

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

The emphasis will need to be on consolidation and so while the member can opt-out they should still decide to transfer to a new provider within a set timescale. However, we can foresee a number of small legacy funds persisting. This may have to be accepted as unavoidable.

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

Similar to the points made above – only where the proper process cannot be demonstrated to have been followed.

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

Regulations exist to protect this area and best practice guidance should be followed.

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

Yes. Trustees have overriding fiduciary duties which should apply.

Question 25: How should the cost of the transfer be borne?

This is a good question and is not clear and may well depend on circumstances. The principles must be established that the member should not meet the costs, but an acceptance is that this may not be avoidable. first port of call should be the providers, then scheme “excess” assets if they exist, employer and finally the member as a last resort.

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

Advice costs, communications, data tracing/processing, investment transition and market costs.

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

As noted above – members may lose protections and guarantees – although these could be protected. No guarantee that the new provider will be better. However, if bigger is better they could experience better support and user experience, better governance and investment performance.

Members may also lose access to an investment strategy that is better aligned to their personal needs, particularly ‘at retirement’, unless they become a ‘self-selector’. Some thought needs to be given to allowing members to access ‘pre-packaged’ strategies in the run-up to retirement that are somewhere between the single’ default fund’ and a free choice self-select approach.

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

We think there is a consideration to give responsibility to one regulator.

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

This could be crucial if the government wants alignment between employer and adviser on goals. Having a named individual bring accountability to the board and ensures discussions being had at the appropriate level. The government should consider it applying to businesses of a minimum head count. We’re not sure on size but perhaps 250+ could be a starting point.

The role should be proportionate to the size of the business and perhaps ratchets up as employer size increases.

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

Very nervous of the impact on smaller employers and the focus for this should be on larger employers only. Smaller employers will generally use mass products like NEST.

However, engaged employers are very helpful in getting good outcomes for savers. In our experience of working with employer for many years on the selection of a workplace pension scheme we see clear evidence that this can result in better “value for members”, demonstrated by negotiating competitive charges, selecting the most appropriate investment options and facilitation member engagement and communication initiatives.

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

Regulation of advisers will raise standards as part-time advisers will exit the market. This will mean good quality advisers who consider whole of market and the whole value chain will be preferred. We support this and think it could be crucial to the success of the policy.

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

Given the evidence that productive finance will provide better outcomes for members is yet to be borne out we don’t think just by regulating advice it will help achieve the policy aim. Indeed, many providers already take external advice on investment strategy from ‘investment consultants. The recent CMA Review suggested that there is not enough competition in this area, so this may lead to ‘group think’ and not necessarily result in higher allocations to productive assets.

Regulated advice would help ensure key considerations are taken into account when formulating investment strategy. This would include diversification aspects and sensible methodologies that can be used to assess what proportion of assets to allocate to illiquid investments.

Question 33: How many AE workplace default arrangements and default funds do you have?

No comment.

Question 34: What is the total AUM you have across all these AE workplace default arrangements and default funds?

No comment.

Question 35: Do you have a small number (for example 3-5) of AE workplace default arrangements/funds that cover the majority of these assets and if so, how many of these are there?

No comment.

Question 36: Have you previously combined default funds or arrangements together within the same organisation?

No comment.

If ‘yes’, do you have an estimate of the cost of this (overall or on a per pot basis)?

If ‘no’, do you have an estimate of how much you think this might cost (overall or on a per pot basis)?

n/a

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

If ‘yes’, did you experience any barriers in this process? If so, could you set out what these were, if and how they were overcome, and how long the process took?

No comment.

Question 38: Do you currently charge different price levels to different employers for the same default fund?

No comment.

If so, what is the average price charged to members compared to lowest decile charge and 90th decile charge?

Question 39: Do you have experience of bulk transfer of pots within the same organisation?

No comment.

If 'yes', do you have an estimate of the cost of this (overall or on a per pot basis)?

n/a

Question 40: Do you use the same defaults across the two offerings?

No comment.

What has been the comparative investment performance and average cost/charge between the two for young (30 years before retirement) and older savers (1 day before retirement)?

No comment.

Do you see a noticeable difference in the offer between your MT and GPP product?

No comment.

Question 41: What is the estimated cost to an employer of reviewing a pension scheme every 3 to 5 years?

No comment.

Question 42: What proportion of employers are estimated to use formal advisers when choosing, or switching, a pension scheme?

No comment.

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