

DWP

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Dear DWP team

LCP's response to "Helping savers understand their pension choices"

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We have a specialist DC practice and advise nearly 150 DC schemes, with assets in excess of £60bn in total, which provide for over 6 million UK DC savers. This includes both single sponsor arrangements and master trusts.

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Introduction

We believe there is a great opportunity to broaden access to a base level of decumulation support for workplace savers, predominantly via commercial authorised master trusts and to widen the market beyond the existing advised services available to high earners / those with larger pots. Our response proposes opening the market by allowing commercial authorised master trusts to offer their services to individuals as well as other schemes and trustees.

Response to specified questions

1. Should it be up to trustees to determine the other suitable suites of products?

We agree with this in principle - trustees are those with the best idea of what is in their members' best interests, and therefore they are best placed to design an offering that would support the generality of the membership.

However, what can be put forward for a specific scheme may depend on that scheme's governing documentation. It may very well be the case that at the moment trustees would not be able to make this determination without the agreement of the scheme sponsor (whether single-employer trust or master trust). Therefore, to achieve this objective it is likely that legislation permitting trustees to override the scheme rules in this matter will be required.

We also believe that this legislation should provide trustees with protection from litigation if specified standards are followed. We support many of our clients in creating and partnering with providers to offer a broader suite of decumulation products and one key area is the risk perceived by Trustees and sometimes lawyers on providing these types of products and the risk of being potentially seen to recommend this retirement option/product. We would therefore ask for this protection for Trustees to help ensure all trustees are comfortable that this is part of their remit and they have protections in place.

From a members perspective, we agree wholeheartedly with your acceptance in paragraph 42 that in house products and services may not be the optimal outcome for members – we support products being offered and developed to members but we strongly believe that a product offering does not work alone and welcome the work on communication later this year which we think is essential to avoid mis-selling scandals in this area.

We also think terminology needs to be clarified: paragraph 38 refers to members having “the option to choose this default service offered by the scheme”. Does this mean that members will have to make an active decision to choose the decumulation service? If that is the intention then we think a different term other than “default” should be used since in the accumulation phase, a “default arrangement” is one a member is put into when they do not make an active choice. We’d also confirm we’re supportive of member choice and this not being a default option.

2. What can government do to help a CDC-in-decumulation market emerge?

In our view we believe there are several key things that would be helpful for CDC in decumulation to work. The first is the success of CDC whole life schemes (as once this has happened, we expect the market to be more confident in CDC schemes). In addition, we believe legislation for decumulation CDC that is robust and allows simple and fair comparison for savers at the point of retirement to not only compare CDC schemes but also to compare to annuity or drawdown would be helpful.

We remain supportive on innovation for savers at retirement, which CDCs could be a part of, and we feel could have benefits over annuities – however we would prioritise CDC whole life legislation over CDC-in- decumulation legislation and ensure the first is a success.

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

In terms of the minimum requirements that trustees should put in place, we believe that this should be a simple communicated packaged solution, that the trustees believe is suitable for many of their members. This would be delivered via a range of products/ services either directly or through partnerships, that offer access to the flexibilities and support.

We believe that members come to retirement with a wide set of personal circumstances and consequently could benefit from a number of options in decumulation, therefore we remain supportive of a members’ right to choose their suitable decumulation offering (and this is why we believe the work you will do on communications will be essential). If they do not wish to use their scheme’s packaged solution, they are able to access other offerings in the market, for example including master trusts (if these are made accessible via individuals).

Further, as this will be a new market, it is not certain what products will be available and how suitable they will be for all schemes.

Because of this, and to give maximum flexibility to trustees, we believe that the minimum requirements should be as minimal as possible.

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

Ideally, the key factor for trustees to take into account will be their membership demographic profile and needs. However, this will vary from scheme to scheme. Single employer trusts will find this much easier to do than master trusts, who with a much more varied membership, may just have to provide an offering that is likely to be a good value solution for most individuals. This is why we are advocating for maximum flexibility for trustees.

After that, the factor which most trustees will strongly take into consideration will be the VFM proposition of possible decumulation options.

At a more granular level, other factors that we expect trustees will take into account include (some of these apply for in-house solutions and some to partnership arrangements):

- Quality of administration services
- Flexibility of income, ability to drawdown in specific ways, such as tax-free cash only or providing for beneficiaries
- Planning tools and other communication and support for members
- Any guidance or advice service
- Reputation of provider
- Financial strength and history of provider
- Investment options and performance
- Costs - As this will be a new market across the industry, costs are likely to take a number of years to settle, although we expect that providers offering partnership services to other schemes will look at what has been achieved in the contract-based sector under FCA regulation and offer broadly comparable costs.

We would therefore welcome further work to ensure decumulation providers are covered by VFM regulation, as is suggested by this consultation.

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

We think it is important to keep in mind that most scheme members have a low level of understanding of pensions and that there is no short set of questions that can easily get to the bottom of what is suitable for different members. As a result, if this approach of asking questions is adopted, we think that most members will answer “No” or “Don’t know” to the first two questions, and we would expect many to not know the options for question four. Therefore these questions need to be framed within a narrative and explanation of the options and a need for members to think about all their sources of retirement income holistically. We also think that the terminology/ jargon used in these questions should be rewritten.

An alternative approach would be not to ask any questions to guide members and just provide clear information about the options available (although we note that this is easier said than done). We suggest this is explored in tandem with the communication work being undertaken later this year.

6. Are there any other questions we should include in the framework?

These questions centre around a decision that is likely to be one of the most important financial choices a member will ever make – arguably more complex and less understood than, for example, taking out a mortgage. As we set out in our previous answer, the proposed questions risk oversimplifying this process.

But if the questions approach is maintained then it should be expanded to cover at least the following additional decisions:

- **Cash-out:** Does the member want to withdraw all their pot as a lump sum? This may make financial sense when considering smaller pots in the member’s holistic retirement situation.
- **Duration:** The questions should allow the member to consider their needs now and several years after their retirement, for example by explaining options to members such as our [“flex first, fix later”](#) proposal.
- **Dependants:** Members should be encouraged to consider what provision they wish to make on their death for their dependants.
- **Other savings:** Members are very unlikely to have a single pension pot, the optimal outcome for members is likely to be when considering all pots and other savings to make a decision on the products needed in retirement.

However, we also note that the more questions that are added, the more the process will look like a full fact-find process by an IFA and therefore increases the risk of trustees straying into giving advice to members. Consequently we would repeat that we think alternatives to the question approach should be explored further.

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

The advice/ guidance boundary is a perennial “friction” for trustees who wish to help their members to their full ability but feel hamstrung by fears of crossing over the boundary. Having said that, if the intention is that trustees choose to make options available for all their members and then an individual member decides what is best for them then we do not think the boundary should be any more of an issue than it normally is. We welcome the review FCA is undertaking with HMT on this.

A separate issue we can see that may frustrate members is where a scheme’s signposted decumulation solution is an FCA-regulated drawdown provider. It appears that members would have to engage with these questions, before transferring to the provider, at which point they may be presented with further questions mandated by the FCA for investment pathways. To members this is likely to appear to be unnecessary duplication and hindrance which could lead to disengagement by members.

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

As we stated in our response to the VFM framework consultation in March, we support extending the VFM framework to decumulation and that the same principles used in the accumulation phase should also be used for measuring VFM in decumulation, with the addition of considering the longevity of the income (not just risk and return metrics as is being suggested for accumulation VFM); and the support and advice offered before and throughout retirement. .

We also believe that the factors we suggest in our answer to Q.4 should also be considered when determining if a scheme is giving good VFM to its members.

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

In our experience most schemes only do what they are required to do, eg signposting members to MaPS and carrying out scam checks. We’re strongly of the view that there needs to be a more developed decumulation product market that members can access, as now members cannot freely access the products available by Master Trusts if they are not connected, or signposted, to that provider. We’d like to see all DC retirees of the future able to access a wider market and for there to be safeguards around this.

10. Do you use the same charge structure as you do in the accumulation stage?

Generally, our clients offer decumulation services using the same charge structure as in accumulation (ie a charge that represents a % of assets). Some schemes and products have lower absolute fees during accumulation (as the employer meets some of the costs – a key benefit) and then members move to a product where there are no employer subsidies on cost at retirement, but the cost is in itself still competitive. These considerations should be part of the VFM framework taken into account when identifying solutions. Any transaction costs should be included in the considerations as well.

11. We would welcome views to understand what are the practical considerations of partnering arrangements?

There are several considerations when it comes to setting up a partnering arrangement:

- **Capability to make a decision:** Many trustee boards will need advice from a consultancy, and many will take legal advice, to decide whom to partner with. This service will add to the cost of the scheme, although we envisage that partnering arrangements will be intended to be long-term and not put out to re-tender excessively frequently.
- **Authorisation of partners:** We believe that providers offering partnering arrangements should be subject to authorisation, akin to master trusts. However, as the market for partnering is currently limited and dominated by a small number of players we’d like to see DWP push for more providers in this space. (We note that it would not be appropriate to require *all* authorised master trusts to offer decumulation partnering arrangements to third parties since several master trusts are non-commercial.)

- **Longevity of partner:** We have seen in the master trust market that authorisation by itself is not a guarantee that a provider will continue in the long-term. Therefore, likely longevity of a partner will be a consideration for many trustees.
- **“Match” to scheme requirements:** Trustees will be keen to ensure that any partnering arrangement is appropriate for their membership’s demographics and needs. It is not possible to currently predict how much flexibility a partner provider will be willing to offer to a specific scheme, but it is likely to be quite standardised (albeit larger schemes may have more clout to get changes made)
- **Cost:** Cost, and the overall value, will invariably be a consideration when choosing a decumulation partner.
- **Capacity:** This will be a new developing market and it is far from clear how much capacity will initially be available for trustees seeking partnering arrangements. In turn, this will have an impact on the costs of such an arrangement. Overall, we would note that the implementation of a decumulation provider, can be a large project and combined with selection can take one to two years depending on the sophistication of the offering, the functionality of the accumulation and decumulation administration and the level of sophistication of the communication and support given to members. This is in part due to trying to make the process member friendly, given that in practice to access the freedoms will often involve a transfer in the first instance (and associated compliance and checks), before any income can be set up in the new scheme.
- **Liability:** There remains caution with many trustees and their legal advisers about partnering with other services / schemes and in particular, avoiding being seen to recommend any specific solution. Further guidance or a lower bar to overcoming (for example if the partnership is with an authorised master trust) would be beneficial.

12. Should government set out a minimum standard partnering arrangement?

We believe that the minimum standards should be “light touch” so as to permit schemes to set up arrangements that are most appropriate to their members. As mentioned in earlier questions, the supply of third parties willing to accept decumulation business from schemes is limited, for example some master trusts and providers only offer their retirement services to their existing members. Therefore, we would support legislation to widen the availability of decumulation offerings as we believe all members should be able to access decumulation innovation and it should not depend on the Master Trust provider, or trust based provider, they have for accumulation.

13. – Question 13

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

We believe that all schemes should be allowed to establish partnership arrangements. And as alluded to above, it is possible that larger schemes will be able to achieve better partnering terms than smaller schemes. However, some schemes may find it difficult to establish a partnership arrangement. For example, some schemes may only have a small number of retirees per year which may mean that commercial Master Trusts will not partner with them (as the business is unattractive). Schemes may also have complex benefit structures (ie underpins etc) which may be another reason scheme may find it difficult to find a partner. Consequently, we think either NEST needs to offer a solution so all schemes can have a suitable decumulation offering (see question 14) or the commercial Master Trust market needs to be opened to all schemes and individual members.

(However, we assume that SSASs and EPPs will be exempt from these requirements.)

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

Yes. Some trustees may be unable to find competitive terms from commercial providers and therefore a “provider of last resort” should be available and we believe that Nest could fulfil this role. Many decumulation providers will reject schemes with members with small pots, we therefore think it is essential that these members also get a good decumulation offering in retirement and would be supportive of Nest undertaking this role,

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

We believe that legislation will be needed in order to give trustees the necessary protection from litigation. Any approach which is based on guidance is likely to lead to a muddled situation and leave trustees open to claims of maladministration.

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

It seems to us that finding parliamentary time to implement these changes is likely to be challenging in the near-medium term. Therefore all we will say is that the government needs to continue with an open and transparent dialogue about what the timescale is likely to be and that there should be at least eighteen months for schemes to set up their arrangements after final legislation has been made and that you should consult on whether a phased introduction is needed, for example applying this legislation to Master Trusts first to develop the decumulation market products.

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

From a practical perspective, there is an argument to say that (commercial) master trusts are probably best equipped to introduce these arrangements first and that by doing so, a viable market would be created from the start, from which any teething issues could be sorted out, before opening it up to smaller schemes (in a similar way to how the original Dashboards staging timeline would have worked). On balance, we believe that this will be better than a “big bang” approach, although we acknowledge that this will lead to regulatory arbitrage in the options available to members depending on what scheme they are in.

As a result of this potential arbitrage, and as noted earlier, our suggestion would be to include opening up commercial master trust schemes to individual members for decumulation to create a market (although we accept that this will require defining a “commercial” master trust for this purpose).

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

We have no objection in principle to Nest being permitted to provide the services outlined in this consultation – as you note Nest is the largest AE provider and DC master trust so it would be perverse if it were not to do so. We also think that this will benefit Nest’s membership.

However, as stated previously, we believe that Nest and all commercial master trusts should also be required to offer its decumulation offering to any other scheme that wishes to partner with it or individual member that wishes to take income.

19. Are you able to quantify any of the one-off or on-going costs at this stage?

We cannot precisely quantify any costs but it is clear that as this is creating a new service and mass-market that the costs will be substantial.

20. Are you able to provide a breakeven point in pot size for providing certain decumulation products or services? Would this be different for decumulation only CDC’s?

[N/A]

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

Intangible benefits are likely to be increased confidence in the pensions system. Over time, better member outcomes due to higher retirement incomes should be measurable

22. Do you think the benefits from the proposed changes outweigh the costs

Yes. Over the last few years, significant steps have been made to improving the accumulation phase of DC saving. It is now right, and overdue, that similar attention is paid to the decumulation phase. This is essential so that the good work in improving accumulation is not lost at the point that member benefits are taken.

Conclusion

We welcome the opportunity to respond to your consultation on this important topic. If the correct decisions are made then these will lead to better member outcomes. We would be delighted to discuss any of these points with you.

Yours sincerely

By email only 16.45 5 September 2023

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