Helping savers understand their pension choices

Isio's response

4 September 2023

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Isio's view

This document is Isio's response to DWP's consultation on 'Helping savers understand their pensions choices: supporting individuals at the point of access', dated 11 July 2023. We have set out our overall comments below and responded to the specific questions asked in the consultation document in the 'Isio's Responses' section of this document.

We welcome the chance to respond to this consultation and believe this is an important area of development for the DC market. We have not answered all of the questions but concentrated on those areas where we believe we have relevant knowledge and expertise.

We believe that the DC market is coming forward with good decumulation solutions, so we do not believe that aggressive regulation of this area is needed at this stage. Instead, we believe that regulatory guidance should be sufficient in the short term. Legislation could follow later if significant deficiencies in the decumulation market remain.

We support the need for trustees to develop default decumulation options for those members who do not engage on their preferred decumulation solution, however we believe that trustees (and the employers that sponsor and/ or participate in the schemes) are best placed to determine which options best suit their membership.

We are very supportive of good information and education for members as they move through the accumulation stage and start to think about retirement planning. We believe that this is the best way to ensure that members understand their options and make decumulation decisions that suit their circumstances.

To facilitate provision of good decumulation options, we support the development of partnership arrangements. We also support the development of a decumulation-only CDC option. We have set out safeguards we believe would help partnership arrangements and CDC options to be successful in our detailed answers to the consultation questions.

Finally, although we haven't answered all of the questions in Chapter 5 on impacts, we believe that the proposals will add advisor costs for pension schemes and this needs to be acknowledged. However, better decumulation options will be of substantial benefit to scheme members so we welcome any positive developments in this area.

Please feel free to contact us about our response.

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Isio's responses

Chapter 2: What we propose

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

Trustees have a fiduciary duty to scheme members and so should not be recommending products that they do not believe are in the best interest of the members. However, some members choose not to engage with trustees as they approach retirement, so we believe that it is important for trustees to consider what an appropriate decumulation solution might be in these circumstances. Hence, they should have a default decumulation solution for these members. The default solution may not be a single solution covering all members. For example, it may be appropriate to have separate default solutions for different pension pot sizes, with small pots being paid out fully as cash and larger pots paid as a mixture of cash and income. Trustees are best placed to determine which set of default solutions best suit their membership.

Employers will also have an interest in the decumulation solutions provided by their employees' scheme. It will be important for the trustees to be able to describe the decumulation solutions they offer (including defaults) and the charges associated with them.

We do not believe that any particular default solution needs to be mandated by regulation. However, it would be reasonable for regulators to encourage and guide trustees to have such a default, or defaults, with regulations and enforcement to follow later if encouragement and guidance proves insufficient.

Most importantly, we believe that members should be given good information and education about their options to allow them to make positive decisions on how they wish to approach the decumulation phase, reflecting their individual circumstances and needs. This would mean fewer members would need to use the default solution.

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

It is important for CDC schemes to achieve sufficient scale to allow the longevity pooling to operate safely and so that selection against the scheme is not a significant problem. As such, we believe that it is important for a whole-of-life CDC market to develop first. These schemes could build the necessary scale. If successful, this would act as a 'proof of concept' and encourage a decumulation only market. Notwithstanding this, we believe that the authorised master trusts would be a reasonable place for a decumulation-only CDC market to start. As a sector, the master trusts have the scale and sufficiently large flow of new entrants and retirees to have the best chance of launching a decumulation-only option successfully.

Care is needed in the regulation of CDC schemes (including decumulation-only schemes) to ensure that competition does not drive costs so low that schemes end up making claims about the benefits members will get that cannot be delivered in practice.

We believe an information and education program for trustees and sponsors may help to encourage a decumulation-only CDC market. This could be run by Government and/ or regulators and use the experience of the existing CDC scheme as a basis for this.

Finally, a CDC consolidator vehicle that could be used to consolidate CDC schemes that fail to become commercially viable (ie they don't achieve the necessary scale) may help to persuade providers to create CDC decumulation-only vehicles. This would provide an exit strategy for such schemes which would also allow members to continue participating in a CDC scheme. Nest may be a suitable vehicle for this.

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

We believe that trustees need to explain the options available to members facing retirement thoroughly. The aim should be to allow members to make positive decisions on how they wish to approach the decumulation phase, reflecting their individual circumstances and needs. This would mean fewer members would need to use the default solution.

As noted above, we do believe that any particular default solution needs to be mandated by regulation. However, we also believe that trustees need to have a default decumulation solution for those members that do not engage with them. Trustees would be best placed to choose the default or defaults that would best suit their membership.

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

Trustees should take account of the needs of the members when developing their decumulation offer (as per their fiduciary duty). As well as considering members' pensions savings, trustees might consider members' wider financial circumstances, such as debt levels, housing tenure, need for social care etc. Member needs might also be different for different categories of member and employment and different levels of pensions savings.

However, we do not believe that including these wider considerations in the decumulation offer should be mandated. It should be sufficient to offer trustees guidance in this area and allow trustees to consider the factors they believe are most suitable for their membership.

Question 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?

The four investment pathways questions represent a good start but, in practice, members will have a wider range of concerns than implied by these questions. For example, members will want to consider cash lump sum options at retirement and whether they need inflation protection in retirement. They will also want to consider provision of benefits to dependents or more general wealth transfer to the next generation and may also have broader tax efficiency and/ or State benefit concerns. Finally, as noted elsewhere, members with different levels of savings may have different needs. For example, members with small pension pots may simply wish to cash out.

We believe that it ought to be for the trustees to determine the decumulation solutions they offer (including defaults). This will allow trustees to provide solutions suitable to their membership, help members to decide which option is best for them and help employers choose a scheme with options appropriate to their employees.

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

As noted in our response to question 5, there are many questions that are relevant to retirement planning. We listed some in that answer. However, we do not believe that such a full list of questions should be mandated in a framework. It should be left to trustees (and the employers that select and/ or design the scheme) to determine a framework appropriate to their membership's needs.

As noted elsewhere, we believe that members should be given good information and education about their pensions to allow them to make positive decisions on how they wish to approach the decumulation phase, reflecting their individual circumstances and needs. This would mean fewer members would need to use the default solution. Any framework should concentrate on this.

Question 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.

Investment pathways are a relatively new concept. It is potentially too early to determine how successful they have been. In particular, take up of the pathways has been very variable across the industry, so it is difficult to come to any firm conclusions on their success or otherwise.

We note that the pathways are not necessarily joined-up to a scheme's decumulation offer. They are essentially a five-year holding pattern for members approaching retirement which is probably better than having no indication of a member's intentions at all but they are not necessarily joined-up with a decumulation offer.

Question 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?

We believe that metrics should concentrate on the following areas: benefit stability (eg is there inflation protection), economic value (ie how the value of the benefits paid compares to, say, an annuity purchased at normal retirement age), cost transparency, availability of death benefits and ease of understanding. The flexibility for members to change their decumulation option to reflect changing life circumstances (eg terminal illness and social care needs) is also important.

It will be important to make sure there is a consistent approach across schemes to make for easy comparison between schemes.

Question 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?

We note that CDC options will not be covered by the Financial Services Compensation Scheme. Members will receive a 'share of fund' DC pot if a CDC scheme closes. As noted elsewhere, it might be beneficial to develop a CDC consolidation vehicle to receive closing CDC schemes.

Guardrails on drawdown are already in place to cope with funds being drawn down too quickly or too slowly. For example, providers alert members of the age at which their pension pot is expected to be entirely used up. We are fully supportive of information and education for members to help them understand longevity risk and how they can best plan to use their retirement pots through the decumulation phase to suit their circumstances.

As noted elsewhere, it is also important for members to be able to understand charges and understand what flexibilities exist to change their decumulation options to suit changing circumstances. Information and education for members on their options are important safeguards in themselves.

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

We believe that costs in the decumulation stage are often higher than in the accumulation stage, reflecting the additional administrative costs for providers in this phase. CDC would be more costly still. However, we believe charging structures (if not charge levels) should be the same across both phases.

We believe that total expense ratios are the most transparent way of communicating costs.

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

The practical considerations would include finding a suitable partner in the first place and having the necessary skills on the trustee board to make a good selection and to review the partnership relationship periodically after that and also to end and replace a partnering relationship if necessary.

Financial considerations would include understanding how liability is apportioned in the event of partner failure – this may differ between different decumulation options and may be very different if the partner is providing a CDC option.

Question 12 – Should government set out a minimum standard partnering arrangement?

We have no firm views on this question but agree that it is important for trustees taking decisions on decumulation solutions to have partnering arrangements as an option.

A possible approach would be to allow partnering arrangements with authorised decumulation providers only or to require that trustees take advice on design and transition to any partnering arrangement from regulated advisors.

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 enter into partnership arrangements. It should be left to the trustees and sponsoring employers to determine what is best in their situation. This is subject to the practical and financial considerations we laid out in our answer to question 11.

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

We are not opposed to having a centralised scheme for this purpose. It could provide a useful additional option for members. It might also serve as a useful consolidation vehicle where other decumulation-only CDC schemes fail to reach the scale sufficient to make them viable, as per our answer to question 2. A well run and well governed central scheme could help 'set the tone' for the market in terms of pricing and decumulation solution design.

Chapter 3: Implementation

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

In our experience, providers are already coming to market with decumulation solutions so this issue will be at least partially resolved in time. Value for money initiatives will provide further impetus for the drive to provide good value decumulation solutions. So, at this stage, guidance for trustees and sponsors may be sufficient Indeed, mandated minimum standards may drive the market towards those minimum standards where competition is based only on charges, as has been the case for the accumulation phase to date. That would be unfortunate.

We believe that the same standards need to apply to all schemes. However, to help establish best practice, it would be reasonable to apply the standards to the larger schemes and the authorised master trusts first before rolling it out to smaller schemes later, in the same vein as the staged implementation of auto-enrolment and TCFD requirements.

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

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

As noted in our answer to question 15, we believe guidance should be sufficient to begin with, with legislation following if needed. However, whichever route is followed (guidance or legislation), we believe the same standards should apply to all schemes. In order to help establish best practice, it would be reasonable to apply standards to the larger schemes and master trustees first before rolling out to other schemes later.

Chapter 4: Role of Nest in Decumulation

Question 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 believe that it would be reasonable to enable Nest to provide decumulation services in the same way as other schemes. As noted elsewhere, Nest may provide a CDC option that could act as a consolidation vehicle for such schemes.

Chapter 5: Impacts

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

Decumulation solution providers are best placed to answer questions on costs and benefits of decumulation solutions. However, it is clear that the proposals in this consultation will lead to new advisor costs and this should be acknowledged.

As we have noted elsewhere, we are broadly supportive of developments in the decumulation phase and believe they can prove beneficial for pension scheme members as well as trustees and sponsoring employers if implemented well.

Question 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?

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

Question 22 – Do you think the benefits from the proposed changes outweigh the costs?

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