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Work and Pensions Committee

Progress with automatic enrolment and pension reforms

Fourth Report of Session 2014–15

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Contents

Summary

Progress with automatic enrolment

Automatic enrolment (AE) requires employers to enrol their employees in a workplace pension scheme, provided employees meet the qualifying criteria and do not choose to opt out of the scheme.

The policy was developed during the years following the 2005–06 Pensions Commission, as part of a package of pension measures, with the aim of increasing both the number of people saving for retirement, and the amounts being saved.

Implementation of AE began in October 2012 with the largest companies, and the process will continue through all medium, small and micro businesses until 2018. There are some lessons to be learned from the process but it is widely regarded as having been very effective to date. One indicator of success is that current opt-out rates, at around 12%, are much lower than anticipated.

However, only 3% of employers have so far been through the process. The next step–hundreds of thousands of smaller employers enrolling their employees over the next three years–will be a challenge of a very different scale and nature.

The context in which AE is being implemented has also dramatically changed in the last year. In Budget 2014, the Government announced new pension flexibilities which allow people much greater freedom in how they take and use their pension savings.

This has very significant implications for AE. It could make retirement saving a much more attractive proposition and help to achieve AE's aims; but there are also some risks.

Reviewing auto-enrolment and advising on future pension policy

There is almost universal agreement that one of the key reasons for the success of AE to date is that it was based on political consensus, an evidence-based approach and full involvement of stakeholders, having emerged as a policy proposal from an independent commission. The current Government's recent pension reforms have not benefited from the same considered process.

The next Government should establish a new independent pension commission as soon as possible after the May 2015 election. Its role would be to assess thoroughly the impacts of AE and the full consequences of the new pension flexibilities and to advise on any necessary changes, and on amendments required to the legislation. This new pension commission would also be best placed to advise on the range of outstanding AE and wider pensions issues identified in this report. If the new Government chooses not to accept this recommendation, it will need to tackle the issues raised in this report itself, as a matter of urgency.

Bringing smaller employers into auto-enrolment

1.2 million existing small and micro employers will be brought into AE in the period to April 2017, enrolling around 4 million employees. The challenges smaller employers will face are considerable, given that they are generally less well-equipped to cope with employee pension arrangements; are unlikely to have existing schemes; and have fewer resources, including staff, to help them administer the process. This group of employers will need proper support from the Government, the regulators, and pension providers to help them cope, including effective and timely communications about what is expected of them and how they can most easily meet the regulatory requirements AE places on them.

Workers who are currently excluded

Although AE is achieving its objectives in terms of bringing more people into retirement saving, some people likely to benefit remain outside its scope. The AE annual earnings trigger has now been set at £10,000 for 2015–16 (and was previously linked to the income tax threshold). This provides some clarity and simplicity but it means that people on the lowest incomes do not qualify for AE, including those in multiple low-paid part-time jobs. Self-employed people are another significant group excluded from AE.

Reassessing the annual earnings trigger and considering ways of supporting low-paid and self-employed people who are not currently eligible for AE should be early tasks for the proposed new independent pension commission.

Pension scheme charges and governance

Public confidence in the value for money and level of security which pension schemes offer is crucial to increasing retirement saving. This is particularly important now that millions more people are being brought into pension saving for the first time by AE, given that they have not chosen this course of action, nor the pension scheme in which their employer enrols them.

The Government has made good progress in tackling excessive and unnecessary charges in AE qualifying schemes. The 0.75% charge cap to be introduced from April 2015, and the ban on consultancy charges and deferred member charges which will follow, are very welcome. However, transaction costs remain a potential source of detriment to pension savers. The charge caps and bans will also only apply to AE schemes: high charges and poor governance in older "legacy" schemes remain to be effectively tackled. The new independent pension commission should consider these issues as a priority.

Automatic transfers

AE means that a greater number of small pension pots are likely to be created because there will be millions more individuals saving at low levels. An accumulation of small pension pots can cause problems for individuals who may lose track of them, and for pension providers because of the relatively high administration costs.

The Government has legislated for changes which mean that pension pots below a certain level will automatically transfer when people move jobs, from the old employer's scheme to the new employer's scheme ("pot follows member"). A solution to the small pots problem is clearly necessary but it has taken too long for firm proposals to be developed and pension providers have concerns about the cost and logistics of the system. The recent publication of more details about how the process will work is welcome, but implementation is still not due to begin until autumn 2016. The next Government needs to confirm the plans for automatic transfer at an early date, and act quickly to develop workable IT solutions in cooperation with the pensions industry.

The new "Freedom and Choice" pension flexibilities

In Budget 2014, the Chancellor of the Exchequer announced reforms which will allow people much greater freedom to access Defined Contribution pensions, by changing the way that pension saving is taxed when it is accessed. The most significant of the changes, which will be implemented from April 2015, is the removal of the requirement to annuitise.

These new flexibilities were initially broadly welcomed, although some concerns have since arisen. It is recognised that these changes will give individuals greater freedom in how they use pension saving and may encourage increased retirement saving as pensions will not be "locked away" to the same extent.

The pensions industry will need to be innovative in devising a wider range of retirement investment products. This should include more flexible annuity products, given that annuities are likely to continue to be the most appropriate option for many people who want a secure and predictable income in retirement, but who may wish to combine an annuity with a lump sum and/or drawdown arrangement.

Protecting savers

There are also significant risks for individuals from the new freedoms. These include: failing to make provision for the whole period of retirement or making decisions resulting in insufficient income in retirement; and exposure to fraudulent, mis-sold or detrimental financial products.

The Government has acknowledged the potential risks and has established a guidance service, branded as Pension Wise, to provide support to savers at the point at which they can access their pension pots. This is a welcome and necessary step, but it will not be sufficient in itself to mitigate the risks that individuals will face. It is questionable how meaningful a 45-minute guidance session can be, given the general low level of savers' understanding of retirement saving and financial products. Savers who choose not to use Pension Wise also need to be protected, including from the pensions industry itself.

A key underlying issue is the continuing "asymmetry" in the relationship between the pensions industry and savers in terms of levels of awareness and understanding of pensions. This asymmetry is probably greater in pensions than in relation to any other consumer goods or services and gives rise to a lack of trust in pension saving.

This lack of trust has been exacerbated by the pensions industry's poor record on acting in savers' best interests when they access their pension pots, particularly in relation to annuities. Savers have previously suffered detriment because some providers did not do enough to ensure that they purchased the right annuity product from the right company. This is unacceptable. Pension providers need to do more to save consumers from taking poor decisions, by focusing on consumers' best interests rather than their own.

This will be assisted to some extent by the Financial Conduct Authority's (FCA's) recent change of view on the need for providers to offer "additional protection" to savers (also known as the "second line of defence"), beyond signposting them to Pension Wise and discussing the tax consequences of their decumulation options (the point at which savers are able to access their pension saving). From 6 April 2015, providers will now have a duty to carry out some basic checks with savers about their personal circumstances, before they take decisions on using their pension saving. This is a very welcome improvement to the protections for savers.

The regulatory framework

Responsibility for pension regulation is currently divided between The Pensions Regulator (TPR) and the FCA, with HM Treasury and the Department for Work and Pensions (DWP) also playing a part. The Government was previously reluctant to accept our 2013 recommendation that the case for a single pensions regulator should be examined. The Minister for Pensions has recently indicated that he is now more attracted to the idea of a single regulator.

The case for taking this step is even stronger now, given the greater risks to savers from fraud, and detrimental financial products, which accompany the undoubted advantages of the new flexibilities. A single regulator would have a clear focus on the whole retirement saving process, from enrolment in a pension scheme to decumulation and beyond, which the current arrangement lacks. Savers would have clarity on who was responsible for providing guidance and redress, and employers and the pensions industry would have a single body to advise and supervise them. The Minister also suggested that it would be sensible for pensions to be dealt with by a single government department. This would reinforce the case for a single regulator.

1 Introduction

Key elements of automatic enrolment

1. Automatic enrolment in workplace pensions (AE or "auto-enrolment") was introduced under the Pensions Act 2008 to address widespread under-saving for retirement.[1] The current Government's stated intention in implementing AE is that it will "transform the culture of saving", helping people to save more and to have fuller working lives so that they can enjoy a level of retirement income that meets their expectations whilst keeping the burden on employers and industry to a minimum.[2]

2. AE requires employers to enrol qualifying employees into a workplace pension scheme unless the employee opts out; minimum contributions must be paid by both employers and employees; and a compliance regime has been established to ensure that employers meet their obligations. The National Employment Savings Trust (NEST) has been set up, with public funding, as a low-cost pension scheme, with a public service obligation to accept all employers and employees, particularly those groups who have traditionally been under-served by the pensions industry.[3]

3. A phased implementation of AE began in October 2012, with staging dates based on the number of employees an employer has. The timetable for full implementation is shown in the Table below.

Table 1: Timetable for AE implementation[4]

Employer size	Staging date[5]
Large employers (250 or more workers)	October 2012 to February 2014
Medium employers (50 - 249 workers)	April 2014 to April 2015
Smaller employers (49 workers or less)	June 2015 to April 2017
New employers (established after April 2012)	May 2017 to February 2018
Employers who chose to use Defined Benefit or Hybrid Schemes	May delay their staging date until 30 September 2017

43,000 large and medium employers had enrolled over 5.1 million employees by the end of December 2014. 1.2 million existing smaller employers are due to implement AE for around 4 million employees over the period to April 2017.[6]

1 Pensions Act 2008

2 DWP, *Workplace Pension Reforms Evaluation Strategy*, July 2011, pp 1–2

3 DWP, *Workplace Pension Reforms Evaluation Strategy*, July 2011, p 1

4 DWP, *Automatic enrolment in workplace pensions – key facts (Revised edition)*, April 2014, p 6. A small employer is defined as having 5-49 workers and micro employers 1-4 workers.

5 The staging date is defined as: "The date on which an employer is required to begin automatic enrolment. It is determined by the total number of workers in an employer's largest PAYE scheme". See DWP, *Automatic enrolment: Qualitative research with employers staging in 2014*, January 2015, p 14

6 TPR, *Automatic enrolment: Declaration of compliance report*, January 2015, p 1. These figures cover the period July 2012 to end December 2014. However, it should be noted that the link is to a version of the compliance report which is updated automatically each month; and no archive version is readily available. TPR, *Employer staging forecast*, January 2014, p3; HL Deb, 29 January 2015, col GC169

4. Witnesses generally perceived AE as being successful to date, bringing millions of new people into retirement saving, with significantly fewer individuals opting out than was initially predicted.[7] The Government says that AE has started to reverse the fall in membership of workplace pensions.[8] The percentage of people paying into a workplace pension in the private sector increased in 2013 for the first time since 2006, after a pattern of decreasing private sector membership from 2002 to 2012.[9] The latest Office for National Statistics (ONS) figures published in February 2015 show that workplace pension scheme membership increased to 59% in 2014, from 50% in 2013. The ONS says that "the increase is likely to be driven by automatic enrolment".[10]

5. However, employers were keen to emphasise that, although AE has been well-received, it has been complex and time-consuming to implement. It is clear that there will be challenges in extending AE to smaller employers, which The Pensions Regulator (TPR), the body which is responsible for enforcing employers' AE implementation duties, has acknowledged.[11] We examine how these challenges might be addressed in Chapter 3.

About this inquiry

6. We published a report on auto-enrolment and NEST in March 2012 in which we welcomed AE as a policy but highlighted that further work needed to be done to ensure that workplace schemes were governed properly and that scheme charges were set at a level that did not risk financial detriment to consumers.[12] This led to our wider inquiry into governance in workplace pension schemes, on which we reported in April 2013. This report emphasised the need to ensure that the millions of people being brought into pension saving as a result of AE were enrolled into good quality schemes with low charges, and recommended a number of improvements in this respect.[13]

7. In Budget 2014, the Government announced major reforms to pensions. These will allow people with Defined Contribution (DC) pensions much greater freedom to access their savings in retirement by changing the way that pension income is taxed, including ending the requirement to annuitise DC pensions.[14] The changes were legislated for in the Taxation of Pensions Act 2014 and are due to come fully into force on 6 April 2015.[15]

7 Age UK (AEP0029) para 1; Association of British Insurers (AEP0030) para 3; Aviva (AEP0006) p 1; B&CE The People's Pension (AEP0020) p 1; Institute and Faculty of Actuaries (AEP0033) para 4; Scottish Widows (AEP0022) para 1.4; Society of Pension Professionals (AEP0015) para 4; Standard Life plc (AEP0012) para 3; TPR (AEP0024) para 20; Trades Union Congress (AEP0008) para 1.2

8 DWP (AEP0027) para 3

9 ONS website Summary, "Workplace pension membership increases in 2013", 30 October 2014, accessed 5 January 2015

10 ONS, Statistical bulletin: *2014 Annual Survey of Hours and Earnings: Summary of Pensions Results*, 26 February 2015, accessed 26 February 2015

11 Qq2-5; TPR (AEP0024), para 12

12 Work and Pensions Committee, Eighth Report of Session 2010–12, *Automatic enrolment in workplace pensions and the National Employment Savings Trust*, HC 1494

13 Sixth Report of Session 2012–13, *Improving governance and best practice in workplace pensions*, HC 768

14 "Annuitise" means using pension savings to buy an annuity, a financial product that converts the pension pot into a regular income that is intended to last for the rest of the saver's life.

15 Taxation of Pensions Act 2014

These pension reforms are likely to have a profound impact on the way that savers take and use their pension income, which in turn is likely to affect the way people save for retirement.

8. Our starting point for this inquiry was therefore to assess progress with AE implementation, the prospects for its further extension, and the changes to pension governance since our previous report. We have also examined the likely impacts of the new pension freedoms on AE and on pension saving more broadly.

9. We issued a call for evidence for the inquiry in September 2014. We received 39 written submissions and held four oral evidence sessions with a range of stakeholders and the Minister.[16] We also visited NEST's offices in November 2014. We are grateful to all those who contributed to our inquiry.

10. Our specialist adviser for this inquiry was David Yeandle OBE.[17] We very much appreciate the advice and support he has provided.

11. In the text of this report, our conclusions are set out in **bold type** and our recommendations, to which the Government is required to respond, are set out in ***bold italic type.***

16 Lists of oral witnesses and written evidence are set out at the end of this report.

17 Relevant interests of the specialist adviser were made known to the Committee. The Committee formally noted that David Yeandle declared the following interests: Member of NEST Corporation's Employers' Panel; Governor and Member of the Council of the Pensions Policy Institute; Independent President of the United Nations Staff-Management Committee (appointment by the UN Secretary-General); Member of the Employers' Group of the European Economic and Social Committee representing the United Kingdom.

2 Reviewing auto-enrolment and advising on future pension policy

Case for a new independent pension commission

12. Establishing a process for automatic enrolment of employees in workplace pension schemes was a recommendation of the 2005–06 Pensions Commission (the Turner Commission).[18] Witnesses agreed that the success of AE was grounded in the political consensus which the Commission was able to achieve, and from the development of its recommendations with the full involvement of stakeholders, based on an evidence-based approach, leading to "a durable policy settlement from a broad political and stakeholder consensus". Some witnesses were concerned that the 2014–15 pension reforms have not benefited from this same approach.[19]

13. The National Association of Pension Funds (NAPF) contrasted the careful processes followed for introducing AE with the way the current pension flexibilities were being introduced. It called for the establishment of an "Independent Retirement Savings Commission", accountable to the Secretary of State and with a remit to define target retirement outcomes, recommend policy change, and assess the impact of reforms.[20] The People's Pension pointed out that the current reforms would have implications for "decades to come" and was concerned that the speed of change would lead to unintended consequences, sub-optimal outcomes and the need for "further sticking-plaster changes". It called for the establishment of an independent Office of Pensions, to ensure that further policy is evidence-based, and takes a long-term view.[21] Morten Nilsson of NOW: Pensions believed that a new pension commission could assess the dramatic changes which were taking place, particularly as these would have long-term effects, which may not be obvious at the moment. Standard Life supported these views.[22] The International Longevity Centre UK also published a report in February 2015 calling for a new independent pensions commission to be set up, "to rebuild consensus-based policy making in pensions and tackle the substantial challenge of insufficient incomes in retirement".[23]

14. The Minister for Pensions (Rt Hon Steve Webb MP) himself referred to the need to avoid "the curse of incrementalism: a good-natured reform here, a well-meaning one there, but no sense of direction". [24] He agreed that the Turner Commission had been "a good thing that did a lot of lasting good" and believed that "independent input" was very valuable. He pointed out that legislation was already in train to establish a body "to gather

18 The Pensions Commission published its First Report in October 2004. This was followed by a Second Report in November 2005 and a Final Statement in April 2006. For more details see the Pensions Commission website

19 See for example NEST Corporation (AEP0034) para 2.1; Standard Life plc (AEP0012) paras 11–12

20 NAPF (AEP0031), paras 14–15

21 B&CE The People's Pension (AEP0020) pp 1–2

22 Q111; Standard Life plc (AEP0012) paras 11–12

23 International Longevity Centre UK, *Consensus revisited: the case for a new Pensions Commission*, February 2015

24 Q269

data and to set out recommendations to Parliament on State Pension age." However, his caveat on establishing a new commission was that these bodies are not a "silver bullet" in developing pensions policy because the decisions ultimately have to be made by politicians.[25] However, he was very keen that his "immediate successor" should "look across the landscape" at an early stage, to assess how all the recent pension reforms, including the new State Pension, were fitting together. Any big gaps should be identified and a five-year agenda set out for addressing them.[26]

15. An important ongoing issue which a new pension commission could help to address is one we identified in our 2013 report: the lack of engagement of the general public in pension saving and what could be termed the "asymmetry" of the relationship between the pensions industry and savers in terms of understanding the complex issues involved in pension saving.[27] The Trades Union Congress (TUC) reinforced the point that the pensions system "is not a functioning market in the way that other consumer goods might be".[28] Later in this report, we discuss measures necessary to protect savers from detriment and to ensure that the benefits of retirement saving are maximised for individuals (Chapter 6). Tackling the imbalance in the relationship between the industry and savers would be a significant step towards increasing protection for savers, on which an independent pensions body would be well-placed to advise.

Reviewing auto-enrolment

16. AE was due to be reviewed in 2017 in the limited context of the restrictions placed on NEST when it was established.[29] The decision on lifting these restrictions has now already been made but witnesses were agreed that there was a strong case for a wider review of AE. [30]

17. The Minister accepted that the 2017 NEST review, although required in legislation, was "redundant". However, he was very clear that AE should be reviewed and that this should happen early in the new Parliament rather than waiting until 2017. He believed that 2017 would be "too late" to start the process because of the time needed to consult on any proposals arising from a review, and then to legislate for and implement the changes.[31]

18. ***We recommend that the next Government take steps to establish an independent pension commission at an early date after the General Election and certainly by July 2015. Its remit should be: to review AE implementation to date; to advise on necessary***

25 Qq246, 270–271

26 Q269

27 Sixth Report of Session 2012–13, *Improving governance and best practice in workplace pensions*, HC 768, Summary and Chapters 2 and 5

28 Q61

29 For a description of the NEST restrictions and their impact, see Fourth Report from the Work and Pensions Committee, Session 2012–13, *Lifting the Restrictions on NEST*, HC 950. For a description of the legislative steps to lift the restrictions, see Explanatory Memorandum to the National Employment Savings Trust (Amendment) Order 2015 No. 178

30 Qq110–111

31 Q269

changes and adjustments to AE; to consider all the implications of the pension flexibilities introduced from April 2015; and to advise government on consequent amendments required to existing pension legislation, and on development of future pension policy. The new commission should be similar in format to the 2005–06 Pensions (Turner) Commission, with a chair and two or three members only, but it should involve the widest range of stakeholders in its deliberations, including the pensions industry, employers, employees and their representatives, pension experts and consumer representatives. It should coordinate its work with the Government's planned independently-led review of State Pension age. If the new Government does not accept that a new pension commission is required, it will need to tackle the range of issues raised in this report itself, as a matter of urgency.

3 Future challenges for auto-enrolment

Measuring effectiveness

19. One initial measure of the effectiveness of AE is the number of employees who have chosen to opt out of their employer's pension scheme within one month of being auto-enrolled. The Department for Work and Pensions (DWP) originally projected opt-out rates of around a third but the actual figures have been much lower at 9–10% in 2013 and 12% in 2014.[32] DWP has pointed to these lower than anticipated opt-out rates as one of the major successes of AE and witnesses acknowledged this achievement.[33] DWP has now revised the headline estimated opt-out rate to 2018 from 28% to 15%.[34]

20. Maintaining low opt-out levels will be an important factor in ensuring the continued effectiveness of AE. Some witnesses have speculated that the level will be affected as AE is extended to smaller employers and as minimum contribution levels increase (see next section).[35] However, TPR, amongst others, did not anticipate that any increase amongst smaller employers would be significant.[36] The Minister noted that there was uncertainty about whether opt-out rates would be affected by the extension of AE to smaller employers and believed that planned minimum contribution increases could be achieved without a great impact on opting out.[37]

21. Opt-out statistics only cover the initial one-month period following an individual being auto-enrolled and do not therefore provide an indication of "persistency" in contributing to pensions.[38] Rates for subsequent withdrawal from AE schemes (known as "attrition rates") appear to be low and the Minister and providers were satisfied that they raised no cause for concern.[39] However, the prospects for sustaining pension saving over the longer term remain uncertain, particularly taking into account the possible impact of increases to minimum contribution rates (see below). Witnesses therefore believed that ongoing participation should be carefully monitored.[40]

32 HC Deb, 2 September 2014, col 196; DWP, *Employers' Pension Provision Survey 2013*, July 2014, para 5.3.4; DWP, *Automatic enrolment: Qualitative research with employers staging in 2014*, January 2015, p 18

33 See, for example, B&CE The People's Pension (AEP0020) p 1; Now: Pensions (AEP0026) para 6; Standard Life plc (AEP0012) para 13; TUC (AEP0008) para 1.2

34 DWP (AEP0027) para 25

35 See, for example, Institute and Faculty of Actuaries (AEP0033) para 4a; Mercer Ltd (AEP0019) para 3; NOW: Pensions (AEP0026) para 6; Pensions Policy Institute (AEP0003) paras 8-9,. Scottish Life/Royal London (AEP0007) paras 12 and 14; Tax Incentivised Savings Association (AEP0014) para 10

36 Q232. See also Q78 [Mr Thoresen, ABI], Q81 [Mr Vidler, NAPF]

37 Qq238, 241

38 The Pensions Management Institute (AEP0011) para 2.2

39 DWP, *Automatic enrolment: Qualitative research with employers staging in 2014*, January 2015, p81, with DWP sample data showing that only 2% of employees left shortly after the opt-out period. See also Qq122-123, 126, where Legal & General reported a 3% "lapse rate" after the initial opt-out period, and The People's Pension indicated that opt-out increased from 5.8% to 6.3% over a 90-day period.

40 Q24; Qq78-84; Q241

22. ***The low opt-out rate for AE to date is an early indicator of the policy's effectiveness in enrolling people into workplace schemes. However, it is not a meaningful measure of the effectiveness of AE policy in the longer term. We recommend that DWP and The Pensions Regulator (TPR) monitor and report on the number of employees leaving AE schemes after the initial opt-out period ("attrition rates") so that levels of ongoing participation in pensions and the impact of increases in minimum contributions can be assessed. The new independent pension commission which we propose should advise on how the effectiveness of AE can be measured in the longer term.***

Minimum contributions

23. Employers and employees are required to make minimum contributions under AE. The Government decided to stage and phase the contribution rates, from a starting point of 1% each for employees and employers, rising to a total of 8%, as shown in the table below.[41] This approach is intended to familiarise individuals with the concept of pension saving at a comfortable level before gradually increasing their commitment.[42]

Table 2: Staging and phasing dates for minimum contributions

Date	Employer minimum contribution	Employee minimum contribution	Tax relief	Total minimum contribution
Employer's staging date to 30 September 2017	1.0%	0.8%	0.2%	2.0%
1 October 2017 to 30 September 2018	2.0%	2.4%	0.6%	5.0%
1 October 2018 onwards	3.0%	4.0%	1.0%	8.0%

In our 2012 report, we concluded that 8% was a realistic initial target for minimum contributions, but that it was unlikely to be adequate in the long run.[43] The Government is keen to encourage saving beyond the 8% minimum. However, it is concerned that increasing the minimum too soon "may increase individuals' perception that saving for retirement is an insurmountable challenge", and possibly lead them to opt out.[44]

24. Witnesses generally agreed that minimum contributions needed to rise beyond 8% but also believed that the burden on individuals and businesses should be minimised.[45] The options available for increasing minimum contributions include "auto-escalation", which would link pension contribution rises to salary increases. The Minister stressed that

41 The Pensions Advisory Service, *'Automatic Enrolment: How much do I and my employer have to pay?'*, accessed 20 January 2015; TPR, *'Contributions and funding'*, accessed 20 January 2015

42 Q81; Q241

43 Eighth Report of Session 2010–12, *Automatic enrolment in workplace pensions and the National Employment Savings Trust*, HC 1494, para 48-9. See also the Second Report of the Pensions Commission which indicated that 8% was the minimum desirable level of contribution: The Pensions Commission, *A New Pension Settlement for the Twenty-First Century: The Second Report of the Pensions Commission*, November 2005, p 7

44 DWP (AEP0027) para 29

45 Q81; Age UK (AEP0029) paras 7, 10–11; Mercer Ltd (AEP0019) para 3; Now: Pensions (AEP0026) para 8; PPI (AEP0003) para 28; Scottish Life/Royal London (AEP0007) para 17; Tax Incentivised Savings Association (AEP0014) p 1. See also Policy Exchange, *Help to Save: Defusing the pensions time bomb*, 2014, p 7

proposals to increase minimum contributions needed to be developed early in the next Parliament, as significant planning and consultation would be required before an agreed approach could be established.[46]

25. ***We continue to believe that minimum contribution rates will need to increase beyond 8% if AE is to be effective in ensuring that adequate retirement income levels are achieved. We recommend that the new independent pension commission which we propose (or the new Government) undertake a consultation on when and how minimum contributions should be increased, as soon as possible after the General Election, with a view to implementing changes before the end of the next Parliament. This is likely to require a reassessment of the definition of what constitutes "adequacy" of retirement income a decade on from the previous Pensions Commission's work on this.***

Eligibility and exclusions

26. To be eligible to be auto-enrolled, individuals must be aged between 22 and State Pension age and earn more than the AE annual earnings threshold and less than the National Insurance Upper Limit. Those who earn between the National Insurance Lower Limit and the annual earnings threshold may choose to be enrolled.[47] At the end of December 2014, the proportion of individuals who had been auto-enrolled and those who were ineligible for AE was roughly equal, as shown in the following table.[48]

Table 3: Workers auto-enrolled and ineligible for AE

	Number	%
Workers who are already active members of a qualifying scheme on the staging date.	9,258,000	47
Eligible jobholders who have had the defined benefit or hybrid scheme transitional arrangements applied to them.	427,000	2
Eligible jobholders automatically enrolled into an automatic enrolment pension scheme	5,135,000	26
Workers who do not fall into any of the above categories	5,090,000	26

Some witnesses believed that the eligibility criteria mean that too many people are excluded, particularly those in traditionally "under-pensioned" groups, such as low-paid workers and the self-employed.[49] The TUC believes that AE should be triggered from the first pound of pay.[50]

46 Q28; Qq43-45

47 DWP (AEP0027) para 20. TPR, 'Automatic enrolment earnings threshold', accessed 18 February 2015: The National Insurance Lower Limit is £5,772 for 2014/15 and £5,824 for 2015/16 and the National Insurance Upper Limit is £41,865 for 2014/15 and £42,385 for 2015/16.

48 TPR, *Automatic enrolment: Declaration of compliance report*, January 2015, p 1. These figures cover the period July 2012 to end December 2014. However, it should be noted that the link is to a version of the compliance report which is updated automatically each month; and no archive version is readily available.

49 Q122 [Mr Nilsson, NOW: Pensions]; Age UK (AEP0029) paras 1, 9; TUC (AEP0008) para 1.4

50 TUC (AEP0008) para 2.16

Low-paid workers

27. The AE annual earnings trigger was initially linked to the income tax threshold and is reviewed each year. Previous reviews have concluded that aligning AE with the income tax threshold "strikes the right balance", noting that, for persistent low earners, the State Pension alone will give them a retirement income which is similar to that in working life.[51] Following the most recent review, the Government announced in December 2014 that it would fix the threshold for 2015–16 at £10,000 per annum (which was the income tax threshold for 2014–15), rather than increasing it in line with the rise in the 2015–16 threshold. It acknowledged that there were competing arguments for and against lowering the earnings threshold, but concluded that £10,000 would be administratively simple whilst including those individuals who would benefit from pension saving. The Minister reiterated DWP's view that those who earn less than £10,000 per annum would receive a similar standard of living in retirement to that achieved in their working lives through the State Pension alone. Little benefit, if any, would therefore be derived from them being auto-enrolled, which would involve a regular contribution of only a matter of pence per week, with all the accompanying bureaucracy for employers and pension schemes.[52]

28. Particular concerns have been expressed about those individuals, primarily women, who cumulatively earn more than £10,000 per annum in multiple low-paid jobs but who do not reach the AE earnings threshold in any single job.[53] The Minister believed that this group was relatively small but agreed that it would be useful to carry out more research about those who are affected. In particular, it would be worth having "time series data", to establish whether people tended to spend their whole working lives in multiple low-paid jobs, or mainly shorter periods.[54]

Self-employed people

29. AE does not apply to self-employed people. Recent labour market statistics show a growing number of self-employed people, totalling 4.59 million in April-June 2014, the highest number at any point over the last 40 years.[55] ONS statistics also show that the percentage of self-employed men belonging to a personal pension scheme fell from 37% in 2005–06 to 25% in 2009–10, and then to 22% in 2012–13.[56] The Minister was sceptical about promoting pension saving options to the self-employed, such as saving with NEST, noting that simply encouraging individuals to save into pensions does not work, which was the reason why the AE approach was needed. However, he accepted that pension provision for this group is "a big and growing issue" which no government has really grasped.[57]

51 DWP (AEP0027) paras 19–20

52 DWP, *Automatic enrolment earnings thresholds review and revision 2015/15*, December 2014, pp 3, 11; Qq247-249

53 Age UK (AEP0029) para 9. See also DWP (AEP0027) paras 20–21

54 Qq250–260

55 ONS, *Self-employed workers in the UK 2014*, 20 August 2014

56 ONS, *Pension Trends, Chapter 7: Pension scheme membership*, 2014 edition

57 Qq261–262

30. ***The AE annual earnings threshold currently excludes a significant number of low-paid workers. We accept that AE needs to be limited to those who will benefit; and that the State Pension is likely to produce an adequate replacement rate in retirement for workers who earn at low levels throughout their working lives. However, it is not clear how many individuals will be affected by the earnings threshold, particularly those in multiple, low-paid jobs, nor whether their exclusion from AE is more likely to be over the short or longer term. We agree with the Minister that more research on this is necessary. We recommend that the new independent pension commission which we propose give early consideration to whether the AE annual earnings trigger needs to be adjusted, and to how those who are currently excluded from AE, particularly self-employed people and those who are in multiple low-paid jobs over longer periods, might be supported to make adequate provision for their retirement.***

Extension to smaller employers

31. We acknowledged in our 2012 report that AE would be particularly challenging for small and micro businesses, but that it was also necessary for them to be included, as their employees have been the hardest to reach in terms of workplace pension provision.[58] The *Making Automatic Enrolment Work* Review, which the Government commissioned in 2010, considered excluding employers with fewer than five workers, but concluded that it would be unfair to deny access to AE to the 1.2 million workers who would be affected.[59] The Government has, however, accepted that smaller employers are likely to face difficulties with AE and that they will need support from a variety of bodies.[60]

Communications

32. A number of witnesses expressed concern that some employers did not yet understand their obligations under AE.[61] TPR acknowledged that further extension was "still a big challenge" and said "we are really eager that all employers realise that this duty applies to them".[62] TPR has committed to write, early in 2015, to all employers who have not yet staged to inform them of their AE obligations. This is in addition to its standard communications process where it contacts employers 12 months ahead of their staging date and then at intervals until they enrol.[63] DWP and TPR acknowledged that the communication needs of smaller employers differ from those of larger organisations. DWP has tested communication changes to ensure that the "messaging and tone" meet the needs of employers with fewer than 30 employees. TPR has simplified its own communications

58 Eighth Report of Session 2010–12, *Automatic enrolment in workplace pensions and the National Employment Savings Trust*, HC 1494, Paras 101–102.

59 DWP, *Making automatic enrolment work*, Cm 7954, October 2010, p 157; DWP (AEP0027) para 41

60 DWP (AEP0027) para 42

61 Qq72, 116

62 Q235

63 Qq225-226

with employers and also plans to simplify and rationalise its template letters which are used by employers to inform employees about AE.[64]

Selecting a pension scheme

33. TPR research indicates that choosing a pension scheme is one of the biggest concerns amongst smaller employers in relation to implementing AE.[65] NEST noted the lower level of resources and expertise which smaller employers have to assess pension scheme quality.[66] Employer representatives suggested that the range of options offered by pension providers may be narrower or less competitive for smaller employers.[67] Witnesses also highlighted the potential vulnerability of smaller employers to whoever might be giving them advice, and their need for support in selecting a provider.[68] DWP and NEST noted that, along with TPR, they were targeting information to the third parties to whom small employers might go for advice, such as accountants, bookkeepers, payroll providers and independent financial advisers, to ensure that they had the right knowledge to support them.[69]

34. TPR is considering publishing a list of providers who will offer AE qualifying schemes to smaller businesses to help them make a choice. It has also developed a "directed journey", intended to guide smaller employers through a simplified enrolment process. This removes many of the choices usually available when an employer auto-enrols, in response to those who asked simply to be told what they had to do in order to comply with the requirements. [70] The Minister noted that NEST is specifically mentioned as a potential provider in TPR communications with employers regarding their AE duties.[71]

35. The People's Pension believed that some providers might face a challenge in coping with large numbers of smaller employers coming to them in a short space of time.[72] However, DWP noted that the six-year timeframe for implementing AE had been set in order to help manage this demand, and other providers were generally confident that they had adequate capacity and efficient processes in place to cope with this.[73] They believed that the increased volume of employers would be balanced by small employers' needs being less complex in terms of the range and variety of employees who would need to be enrolled. This would entail "a less bespoke service".[74] The Minister agreed with this point

64 DWP (AEP0027) para 45-47; Q263

65 DWP (AEP0027) para 49

66 NEST Corporation (AEP0034) para 3.11

67 See, for example, Association of Convenience Stores (AEP0009) para 8; B&CE The People's Pension (AEP0020) p 1; Forum of Private Business (AEP0035) para 10

68 Q35

69 Q115; Q264

70 Qq227-228, 233

71 Q268

72 Q119. See also Forum of Private Business (AEP0035) para 11

73 DWP (AEP0027) para 38; Qq72, 77, 114 , 116 –117

74 Qq117-118, 120

and TPR and DWP both noted that capacity concerns have so far proved unfounded.[75] NEST pointed out that, because of its public service obligation to take any employer, there were capacity implications if other large providers unexpectedly left the AE market; it would need six to eight months to adjust its resource plan to absorb the additional demand, but this could be achieved.[76]

Compliance

36. TPR stated that its approach to compliance was based on the assumption that "most employers want to meet their obligations […] and do the right thing" and was therefore focused on informing employers about their duties, followed by an initial response of support for those who were not compliant.[77] In September 2014, DWP noted that over 99% of the largest employers auto-enrolled without TPR needing to use its statutory powers, assisted in part by the "educate and enable" approach TPR had taken.[78] However, TPR anticipated an increase in the need to use its statutory enforcement powers as the number of employers staging rises significantly. The latest TPR figures on compliance and enforcement support this, showing a significant rise in the number of times it has exercised its powers against employers, especially through Compliance and Fixed Penalty Notices.[79] The Pensions Management Institute (PMI) was concerned that limits on TPR's resources might make it difficult to monitor employers who were deliberately non-compliant, particularly in the case of employers encouraging staff to opt out.[80] However, TPR was confident that it had sufficient resources to deal effectively with compliance, referring to detailed modelling, its discrete funding stream for these activities, and the ability to apply to DWP if more resources were needed.[81]

37. **The challenges associated with the roll-out of AE to smaller employers are significant, given that small businesses have limited resources and time to devote to the process, and less experience in pensions and access to specialist advice than larger employers. It is important that small employers are fully supported to comply with the obligations that AE places on them and that the burden on them is kept to a minimum by making the process as straightforward as possible. TPR appears to have taken this on board to date, particularly in relation to simplifying communications and offering a "directed journey" which removes many of the complications from the enrolment process.**

38. ***We recommend that the next Government take the lead in ensuring that support for smaller employers continues to be coordinated across regulators and providers. The***

75 Q227; Qq263, 266; TPR (AEP0024) para 17

76 Q116

77 TPR (AEP0024) paras 5-6

78 DWP (AEP0027) para 14

79 TPR, *Automatic enrolment: compliance and enforcement, 1 October–31 December 2014*, January 2015; TPR, *Automatic enrolment: compliance and enforcement, 1 July–30 September 2014*, October 2014

80 PMI (AEP0011) para 3.1

81 Qq163, 170, 226

intermediaries which small employers regularly use, such as accountants, bookkeepers and payroll providers, will also have an important role to play and should be used as an effective resource by ensuring that they are properly connected to the process. The new independent pension commission which we propose should assess progress with AE by smaller employers at an early date and advise on further support and adjustments which it identifies as being necessary to complete AE implementation smoothly.

Automatic transfers

39. The introduction of AE means that a greater number of small pension pots are likely to be created because there will be many more individuals saving, and saving at lower levels, and switching between numerous jobs during their working life. An accumulation of small pension pots during working life can cause problems for individuals because of the danger of scheme members losing track of multiple pots, and for pension providers because of the relatively high administration costs. DWP modelling estimated that, without change, there would have been around 50 million dormant workplace DC pension pots within the system by 2050, and that over 12 million of these would have been under £2,000.[82]

40. The Government has therefore taken action to address the small pots problem. It plans to introduce changes which mean that pension pots below a certain level will automatically transfer when people move jobs, from the old employer's scheme to the new employer's scheme ("pot follows member"). This was legislated for in the Pensions Act 2014. The Government rejected the alternative approach, on which it initially consulted, of having an "aggregator scheme" for small pots.[83]

41. When we took evidence in December 2014, pension providers raised significant concerns about the lack of progress in determining the details of how pot follows member would work and the timetable for its introduction. Some witnesses also had more fundamental doubts about whether pot follows member was the right solution. The NAPF said that it was not convinced that it was "practicable in the short term" and that its preferred option was still the aggregator fund model which DWP had rejected. The Association of British Insurers (ABI) believed that there were still "policy challenges" around governance and the necessary technology. Otto Thoresen of the ABI said that he did not have a sense that the policy was "totally thought-through".[84]

42. The People's Pension said in written evidence that pot follows member was the wrong solution. It argued that the industry had "grudgingly gone along" with it but "we are not aware of any provider that honestly believes it will work" in the current system. There was also concern that it would be expensive to operate. When giving oral evidence, Patrick Heath-Lay, the CEO, was more positive. He acknowledged that, "as a concept" pot follows member was a good idea but believed that it was important that it had "good cross-party support" and that the timetable for its implementation did not adversely affect the AE

82 DWP (AEP0027), para 74. See also DWP, *Automatic transfers: a framework for consolidating pension saving*, February 2015, para 2

83 DWP, *Improving transfers and dealing with small pension pots: Government response to the consultation*, Cm 8402, July 2012, p 15

84 Q98

timetable.[85] Legal & General pointed out that establishing an effective scheme member identification system, to ensure that "the right pot goes to the right member when they change jobs", was still being worked through.[86]

43. DWP told us that it had "moved away from the conception of a centralised database and towards an industry-led federated model where different organisations can offer pot matching and pot transfer services to schemes, creating a competitive market".[87] The Minister explained that the "federated model" meant that DWP would not provide the database for the system; private companies would set up "registries" which would operate the databases which would then provide and exchange the data on pension pots held by pension providers. He also made clear that automatic transfers would initially operate on an "opt-in" basis because "that way […] you have validated that it is the right person and the right pot"; requiring savers to opt out would entail more risk in terms of ensuring "you've got the right person" and that the pension pot was going to the right place.[88]

44. DWP published further details about how automatic transfers will operate in February 2015. This confirmed that pots will be transferred where they are worth less than £10,000 (the pot size limit will be reviewed every five years, as set out in the Pensions Act 2014); and first contributions were made from July 2012. It also confirmed that the "federated model" would be used and that the system will be phased in. Phase 1 will be limited to a certain number of schemes and will operate on an "opt-in" basis; Phase 2 will aim to incorporate all schemes and move to pots being automatically transferred unless members opt out, so that even disengaged savers are included. DWP sets out that "any solution must be industry led with the government providing a legislative framework only where necessary to enable an effective solution". It also acknowledges that the challenge of "identity verification of the individual by pension schemes" remains to be resolved. Progress is not expected to be rapid: the next step is to begin to develop the legislation so that the process can be implemented "from October 2016". [89]

45. ***We acknowledge that a system for automatic transfers is essential for auto-enrolment to work effectively. However, progress on developing a satisfactory process has been slow and a significant number of pension providers remain to be convinced that "pot follows member" is the right solution. Publication in February 2015 of the latest detailed plans for automatic transfers is a welcome step, although implementation is still not scheduled to begin until October 2016. We recommend that the next Government confirm the plans for automatic transfers at an early date. DWP will also need to continue to work hard to persuade the pensions industry of the merits of pot follows member. This will be assisted by more rapid progress with the development of workable and robust IT solutions, particularly in relation to scheme member identification, in cooperation with pension providers.***

85 B&CE The People's Pension (AEP0020) pp 2, 6; Qq112, 136, 139

86 Q135

87 DWP (AEP0027), para 76

88 Qq285-286, 298

89 DWP, *Automatic transfers: a framework for consolidating pension saving*, February 2015, pp 5-8, 15

4 Scheme governance and charges

Governance

46. Our 2013 report on pensions governance argued strongly for improved governance of pension schemes, given that AE means that millions more people are being brought into pension saving.[90] Commentators have observed that the new pension flexibilities reinforce the need for good governance, as the increased complexity is likely to make it more difficult for consumers to understand pensions and to make choices in their best interests.[91]

47. Under the Pensions Act 2014, the Government is introducing new governance standards for DC schemes from April 2015. These apply to both trust-based and contract-based schemes.

- Trust-based schemes are generally run and managed by an employer through a board of trustees. In trust-based schemes, trustees have a "fiduciary duty" to scheme members, meaning they are under a strict, legal obligation to act solely in the interest of their scheme members.
- Contract-based schemes are managed by a third party, such as an insurance provider, and operate on the basis of a contract between the scheme member and the provider. In contract-based schemes the provider does not owe a fiduciary duty to the member.

48. DWP set out its final plans for governance reforms in February 2015. Under these changes, new quality standards will apply across all money purchase workplace pension schemes, designed to ensure that scheme trustees and administrators understand the key components of scheme quality and have members' interests as their priority.[92] TPR and the Financial Conduct Authority (FCA) will be responsible for regulating compliance with the standards.[93]

49. For contract-based workplace pension schemes, the Government is introducing Independent Governance Committees (IGCs). This followed a 2013 Office of Fair Trading (OFT) market study, which found that competition alone could not be relied upon to deliver value for money for all savers in DC workplace pensions. IGCs are intended to ensure that all aspects of value for money in pension schemes is independently reviewed, so that savers could be confident of receiving value for money.

90 Sixth Report of Session 2012–13, *Improving governance and best practice in workplace pensions*, HC 768-I, Chapter 2

91 Age UK (AEP0029) para 19; Which? (AEP0023) para 22;

92 DWP, *Government Response to the consultation on Better workplace pensions: putting savers' interests first*, Cm 9000, February 2015, Chapter 2

93 TPR (AEP0024) para 51

50. The key duties of IGCs will be:

- to act in the interests of relevant policyholders;
- to assess and report on the value for money of pension schemes;
- where they find problems with value for money, to raise concerns with the firm's governing body;
- where they are dissatisfied with the action taken by the board, to escalate concerns to the FCA, alert relevant scheme members and employers, and make concerns public; and
- to publish an annual report of their findings.[94]

The FCA says that it intends to be proactive in supervising specific firms in order to ascertain the effectiveness of IGCs, and will consider reviews, amendments to rules or guidance, and enforcement action in response to emerging concerns.[95]

51. Witnesses broadly welcomed the introduction of IGCs. Scottish Widows believed that they would give rise to better outcomes for savers and increase consumer confidence, leading to increased engagement and levels of savings.[96] However, the TUC had concerns about the independence of individuals appointed to IGCs; the powers they will have to effect change; and about "limited encouragement of member representatives".[97]

Costs and charges

52. Our 2013 report on improving governance in workplace pensions included a number of recommendations on reducing charges incurred by scheme members and increasing their transparency.[98] In response to these concerns, the Government plans to introduce a range of restrictions on charges.[99] From April 2015 annual management charges (AMCs) for default funds in AE qualifying schemes will be capped at 0.75% annually.[100] This will apply to all member-borne charges and deductions, excluding transaction costs (see below). When the relevant draft Regulations were laid in February 2015, DWP stated that this change could mean a saving of up to £100,000 for an average earner previously paying a charge of 1.5% over the course of their working life and could mean as much as £200 million being transferred from the pensions industry to savers over the next decade.[101]

94 FCA, *Final rules for independent governance committees, including feedback on CP14/16*, February 2015, Chapter 4

95 FCA (AEP0038) p 3

96 Scottish Widows (AEP0022) paras 5.2-3

97 Qq58-59

98 Sixth Report of Session 2012–13, *Improving governance and best practice in workplace pensions*, HC 768-I, Chapter 2

99 DWP, *Government Response to the consultation on Better workplace pensions: putting savers' interests first*, Cm 9000, February 2015, Chapter 3

100 A default fund is one in which the pension provider will invest a saver's pension pot unless the saver chooses a different option. Default funds are intended to provide a reasonable return without undue risk.

101 DWP press release, 4 February 2015, "Average earners could gain up to £100k in new pension charges reform"

53. Which? has called for the charge cap to be further reduced to 0.5%, citing research showing that the average charge for new members was 0.51% in 2012.[102] NEST is already at this level, charging 1.8% on contributions and an AMC of 0.3%, which results in a combined overall average cost of 0.5% per member. NEST cited evidence from a review by the OFT in 2013 which showed that other providers were following its example on charges.[103] Legal & General said that it remained committed to the principle that no-one would pay more than 0.5%.[104] Chris Curry of the Pensions Policy Institute (PPI) noted that the 2006 Pensions Commission envisaged charges eventually coming down to 0.3%, which is also NEST's long-term aim.[105]

54. However, the ABI believed that lowering the charge cap any further than 0.75% would be detrimental and would work against "a vibrant, competitive workplace pension market". It argued that "consumers are best served by a competitive market with a number of providers competing for business" and that pushing the cap below 0.75% risked losing that competition, particularly with "more resource-intensive" smaller employers being brought into AE. It believed that this meant that providers "need certainty that there will be no further changes to the charge cap in the medium term".[106] Graham Vidler said that most of the NAPF's members were already below the cap (and the NAPF stated recently that its members have an average AMC of 0.43%). However, the NAPF was concerned that possible "unintended consequences" might arise from such schemes having to prove that they were compliant.[107]

55. The Investment Management Association (IMA) believed that more needed to be done to explain "what value for money means" and to ensure that the discussion about charges was connected to quality of service: the cheapest scheme might sometimes be the best for consumers but not always.[108] Chris Curry of the PPI agreed that there was a need to get the balance right between quality and costs; just having a low-cost scheme that did not "deliver what it needs to" would not be helpful.[109] NOW: Pensions believed that some providers had responded to the prospect of the charge cap by "introducing pretty poor investment solutions and very cheap fund structures".[110]

56. The Minister emphasised that the charge cap applied only to default funds, which were intended to be "boring": if savers wanted a more sophisticated investment strategy then they could choose a fund other than the default and pay a higher AMC. He said that it was not simply a case that if 0.75% was good, 0.65% was better, because below a certain point,

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102 Which? (AEP0023) para 14

103 NEST Corporation (AEP0034) paras 2.4 and 4.1

104 Q117

105 Q57

106 ABI (AEP0030) para 11

107 Qq89-90. See also NAPF, *PolicyWatch*, 6 February 2015, p 2

108 Q90

109 Q57

110 Q129

only very few providers would be able to cover their costs and competition was essential for the market.[111]

57. From April 2016, further restrictions will be applied to charges:

- Commission or consultancy fees will no longer be charged in any scheme;
- Deferred member charges (also known as active member discounts (AMDs)) will not be permitted, meaning that members must not be charged more after they cease contributing (for example when they change employers and leave a scheme) than they would if they were still making contributions.[112]

These changes were both recommendations in our 2013 report.[113]

Transaction charges

58. The charge cap will not include transaction charges, which are the costs which arise when funds move pension saving around the investment market. NOW: Pensions warned of the risk that some charges would simply be transferred from those that fell within the cap to uncapped transaction charges. However, it also argued that "it would be quite unfortunate if people are not making the right investment decisions because there is a transaction cost". Tim Jones of NEST pointed out that one way to minimise transaction costs was to reduce the number of transactions by adopting a more "passive" approach to investment.[114] DWP has said that decisions on "whether some or all transactions costs should be included in the default fund charge cap" will be made in 2017.[115] At the beginning of March 2015, the FCA and DWP issued a call for evidence on disclosure of information on transaction costs for workplace pension schemes, which runs until May.[116]

59. Jonathan Lipkin of the IMA pointed out that the creation of IGCs would have a bearing on this as they would have a legal obligation to request information on transaction costs as part of their duty to assess investment performance.[117] The Minister agreed that IGCs would be key to dealing with charges because they will be responsible for ensuring that members' interests are protected.[118] However, TPR research found that only 37% of trustees knew how much investment charges were costing their scheme, which suggests that there is some way to go before IGCs are properly equipped to oversee transaction costs.[119]

111 Qq273-275

112 DWP (AEP0027) paras 67-8

113 Sixth Report of Session 2012–13, *Improving governance and best practice in workplace pensions*, HC 768, Summary and paras 51 and 61

114 Qq130–131

115 DWP, *Better workplace pensions: further measures for savers*, Cm 8840, March 2014, p 4

116 DWP and FCA, *Transaction costs disclosure: Improving transparency in workplace pensions: Call for evidence*, March 2015

117 Q93. The IMA published *Meaningful disclosure of costs and charges: discussion paper* in February 2015.

118 Q275

119 Q178

Charges in legacy schemes

60. The charge cap will apply to AE default funds, but it does not apply to schemes that are not used for AE, nor to savers who cease contributing before April 2015. To address the issue of charges in so-called "legacy schemes", the ABI set up an Independent Project Board (IPB) to examine the risk of savers being exposed to AMCs of over 1% and to recommend actions to be taken by the new IGCs and by trustees. The IPB report was published in December 2014. It stated that the Board had written to each scheme where savers are potentially exposed to high charge impacts, or where savers face exit charges, asking providers by the end of June 2015 to:

- Review their data and conduct any further analysis to reflect any actions already taken to reduce charges or other qualitative factors that might justify high charges;
- Identify what actions could be taken to improve outcomes for savers and what actions can be taken to stop new savers joining poor value schemes; and
- Provide the data, any further analysis and the proposed actions to the relevant governance body.

It recommended that DWP and the FCA jointly review industry-wide progress in addressing and remedying poor value schemes and publish a report by the end of 2016.[120]

61. The Minister was reported in the press as being "shocked" by the IPB's findings, saying that the report had "exposed the guilty secrets of the pension industry". He said that he wanted "big, bold solutions" from the industry before the pension reforms were implemented in April.[121] In oral evidence he said that what had shocked him was the number of different charges that savers could be subject to in legacy schemes (38 in total) and the number of people who had come into such schemes relatively recently. However, he believed that the problem was being "fixed", particularly by banning deferred member charges. His view was that the requirement on providers to resolve these issues by the end of 2016 was "too slow" but trying to address it through legislation was not practical. Instead, he was talking to the big pension providers to persuade them to act quickly.[122]

Transparency of pension charges

62. In our 2013 report, we concluded that the problems associated with high costs and charges were exacerbated by the lack of transparency and clarity in the way providers inform savers about charges and the impact they have on pension pots. We called on the Government to press the industry to increase transparency, given that voluntary codes of conduct were not working effectively.[123] The Financial Services Consumer Panel came to a

120 *Defined contribution workplace pensions: The audit of charges and benefits in legacy schemes*, A Report from the Independent Project Board, December 2014, pp 7-8

121 Financial Times, 20 December 2014 "Pension industry ordered to cut charges"

122 Qq277-279

123 Sixth Report of Session 2012–13, *Improving governance and best practice in workplace pensions*, HC 768-I, Chapter 4

similar conclusion about lack of transparency, in relation to transaction costs, in a document published in November 2014. It too referred to a history of persistent regulatory failure, including problems with self-regulation, in this area.[124] The IMA told us that a great deal of work had already been done to make investment charges, including transaction costs, more transparent and that it expected to issue a framework paper shortly.[125]

63. The Minister agreed that pension information sent to savers should be presented as clearly and consistently as possible, but argued that it would always be "complicated" and that it was better for trustees and IGCs to take the lead in gathering and scrutinising this information. He emphasised that in AE schemes it is the employer who chooses the pension scheme and it is not therefore possible for individuals to use comparative information about scheme charges to decide to move their workplace pension pot.[126] We discuss provision of information to savers, and the possible introduction of a "pensions dashboard", in Chapter 6, on protecting savers.

64. **We welcome the progress made by the Government and the pensions industry in reducing charges and improving governance since our 2013 report. The introduction of the 0.75% charge cap for auto-enrolment default funds is a significant step. However, ensuring scheme quality and value for money for savers is of increasing importance as AE brings millions more individuals into pension saving for the first time, and the complexity of the pensions market increases.**

65. ***The challenges of addressing high charges and poor governance in older ("legacy") pension schemes and of determining value for money in relation to transaction costs are yet to be tackled effectively. We recommend that the new independent pension commission which we propose address these issues as a priority. It will also need to assess the impact of the charge cap and advise on whether it should be further reduced; and work with the pensions industry to develop effective solutions to increase the transparency of all pension charges. We also recommend that the new commission or the next Government consider the level of charges appropriate in the decumulation period and for drawdown schemes.***

124 Financial Services Consumer Panel, *Investment costs – more than meets the eye*, November 2014, paras 2.2-3

125 Qq91-93. The IMA published *Meaningful disclosure of costs and charges: discussion paper* in February 2015.

126 Qq282–284

5 New pension flexibilities

Budget 2014 changes: *Freedom and choice in pensions*

66. In Budget 2014, the Chancellor of the Exchequer announced changes which will allow people much greater freedom to access DC savings in retirement, by changing the way that pension income is taxed. The most significant change is the removal of the requirement to annuitise pension savings. The Taxation of Pensions Act 2014, which received Royal Assent on 17 December 2014, contains provisions which will enable anyone over the minimum age (currently 55) to withdraw any amount they wish from their pension savings at only their marginal tax rate. Scheme members will still be allowed to take 25% of their fund as a tax-free lump sum.[127] The changes will be implemented from April 2015.

67. Witnesses broadly welcomed the new flexibilities. Standard Life, for example, believed that they "should serve to increase the attractiveness of pension saving by reducing some of the psychological barriers associated with 'locking' money away".[128] However, others highlighted that the changes were likely to have a profound impact on the way that pensioners take and use their pension income in retirement, which had potentially negative as well as positive implications. [129]

68. These changes also represent a clear switch of emphasis in pension policy: inertia is used to individuals' advantage in AE by making saving the default, with employees being required to make an active decision to opt out. But under the new pension freedoms, inertia becomes potentially detrimental because all savers are now expected to make difficult decisions about how to use their pension pots, which many people may not feel equipped to do. In this chapter we explore the challenge that the new freedoms present for pension providers. In the next chapter we assess the role of regulators and providers in helping to protect individuals from using their pension pot unwisely; and from the increased risk of fraud and scams.

Response of providers to new flexibilities

69. The pension freedoms are intended to allow savers to take their pension pots in a wider variety and combination of ways, with the expectation that a range of new retirement saving products will be offered beyond the current options of annuities, drawdown and lump sums.

70. Graham Vidler from the NAPF was concerned that its members would not have had time "to develop all of the solutions that people might need to access their money in the full spirit of freedom and choice" by April 2015, "given the late emergence of regulatory certainty". This was particularly worrying given the number of people likely to want to

127 HM Treasury, *Freedom and choice in pensions*, Cm 8835, March 2014, pp 3-4; Taxation of Pensions Act 2014

128 Standard Life plc (AEP0012) para 8. See also DWP (AEP0027) para 26; Q25; Q127; Q237

129 Age UK (AEP0029) paras 2, 9; Forum of Private Business (AEP0035) paras 19, 24-5

access their money as soon as the new flexibilities are available.[130] The number is estimated at around 400,000, which is higher than the estimates for subsequent years, because many savers will have deferred taking their pension until the April 2015 changes are implemented.[131] NOW: Pensions argued that the products initially offered would be expensive and "simply not [...] good enough", although it expected this to improve subsequently.[132]

71. The FCA acknowledged that there was "pent-up demand beginning to build" for new products but believed that at the moment "the market is largely responding by re-badging some existing products" and that there were "relatively few innovative products".[133] TPR believed that many of the schemes which it regulated would not seek to offer drawdown or other innovative products at this stage: they would instead provide a transfer value so that savers could move their pot to another provider which did offer the new flexible arrangements.[134] The Minister acknowledged that many scheme members would need to move their pension pot to another provider in order to take advantage of the new flexibilities. It had never been envisaged that all providers would offer the range of flexibilities because a number of providers lacked the "infrastructure" to offer this; he said "I am not sure we should require every pension scheme not just to be in the business of accumulation but to be in decumulation. That may require different skills". However, he believed that there were "plenty of places" to which savers could move their money which would enable them to access the new freedoms.[135]

"Cashpoint drawdown"

72. The Chancellor indicated in October 2014 that the Government envisaged savers being able to use their pension pots like bank accounts by drawing out varying amounts whenever they needed to.[136] However, the NAPF believed that suggesting that this so-called "cashpoint drawdown" was likely to be possible was "frankly setting unrealistic expectations that mean that people are more likely to be disappointed with what they can do with their pension when it comes to it." The ABI agreed that this proposal was "unrealistic" and argued that it was important that "we do not lose sight of the fact that this is about retirement income as well".[137] TPR agreed that "it will be some time before the market is able to deliver propositions that meet up to that expectation of cashpoint drawdown".[138] The Minister said that although some providers were "talking about"

130 Q101

131 Just Retirement (AEP0021), para 9

132 Q145

133 Qq171, 175

134 Q213

135 Qq300-301

136 The Telegraph, 13 October 2014, "George Osborne: use your pension as a bank account"

137 Q101

138 Qq171, 175

offering this facility, it was likely to be "exceptional" because "the cost would be quite considerable".[139]

Annuities

73. Standard Life believed that there would still be significant demand for "guaranteed or low volatility income solutions", including annuities. However, annuities were likely to need to change from the conventional lifetime annuity currently available, so that savers could be offered flexible or fixed term annuities, and ones that were allowed to increase or decrease payments.[140] Despite the negative findings of its review of annuities sales practice (see Chapter 6), the FCA agreed that "the underlying product itself, for many people […] is still a good product potentially".[141] The Minister said that, although some people had suffered "bad value", he had always been careful "not to say that annuities are a bad thing"; he did not want to be known as the Pensions Minister responsible for "abolishing pensions" by discouraging interest in annuities, because "an income for life until you die is not a bad thing" and annuities needed to continue to be "part of the landscape".[142]

74. The Minister was reported in the press at the beginning of January 2015 as saying that he wanted to introduce further changes to enable existing pensioners to sell their annuities for a lump sum.[143] When we questioned him about this proposal he said that he was not suggesting that people could "exit" from an annuity because it was a contract. But he envisaged offering the possibility of a pension provider or insurance company buying the contract from an individual for a lump sum. He said that the response to his proposal had been positive "within Government" and was being actively looked at.[144]

75. ***It is unlikely that the full range of decumulation options envisaged by the Government will be in place when the new pension freedoms begin in April 2015. Some may be impractical even in the longer term, particularly "cashpoint drawdown" (which would allow savers to use their pension pots like bank accounts). Many schemes will not be in a position to offer the new options, at least at first, and savers will therefore have to move their pots to another scheme to benefit from the flexibilities. Raising expectations that cannot be satisfied could lead to saver disappointment. Annuities are still likely to be the best option for many individuals but they will need to become more flexible—for example by offering fixed term rather than lifetime products, or combinations of annuity, lump sum and drawdown products. We recommend that the new pension commission which we propose assess the impact of the reforms on the range, suitability and accessibility of retirement products and advise on any necessary interventions if the market is not operating in the best interests of pension savers.***

139 Q314

140 Standard Life plc (AEP0012) para 38

141 Q192

142 Q305

143 See, for example, The Independent, 5 January 2015, "Pensioners will be able to sell annuity policies, says Minister Steve Webb"

144 Q307

6 Protecting savers

Potential for mis-selling and scams

76. A number of witnesses highlighted the increased risk of frauds and scams arising from the new flexibilities. Standard Life warned that "we have a very active fraternity of criminals emerging who are seeing a much bigger opportunity in this" than pension providers, and who would no longer need to bother with complicated pension liberation schemes in order to get access to people's savings. The Pensions Advisory Service (TPAS) reported that calls to its helplines indicated that pension scams had already increased since the new flexibilities were announced.[145]

77. TPR said that it had tackled scams through prosecuting perpetrators, but also by raising awareness amongst trustees and the general public, although Stephen Soper, TPR's interim Chief Executive, argued that it was not always possible to prevent people choosing to put their money in schemes that were "not proper", despite the warnings from regulators. He stressed that the regulators were "vigilant" and other agencies, such as the National Crime Agency and the Serious Fraud Office, were involved in the intelligence network around preventing scams.[146] The FCA said that it would "look again at the potential for whether there are new holes that open up new potential for scams and, if need be, we will tighten the rules around that". It detected scams by consumers and providers reporting them; and by monitoring "promotions […] in the press and so on".[147] The Minister said that there was a "huge amount" of disruptive and other activity to combat fraud, not all of which was made public "for obvious reasons". He said that "websites get taken down, premises get raided and people get locked up". He also mentioned the work of Action Fraud against pension scams and frauds.[148]

Past record of pension providers in selling annuities

78. In our 2013 report on pensions governance, we said that the pensions industry was failing pension scheme members when they convert their pension funds into annuities by failing to make them aware of the availability of enhanced and impaired life annuities, which take account of dependants and health conditions, and that better rates might be available from other providers. We recommended that pension providers should be required automatically to supply savers with a comprehensive breakdown of all the different annuity rates available to them from different providers, including options and rates for enhanced and impaired life annuities.[149]

145 Qq58, 61; Q142; Aviva (AEP0023) paras 5.8-9

146 Q177

147 Qq186–189. See also FCA, *PS14/17: Retirement Reforms and the Guidance Guarantee including feedback on CP 14/11*, November 2014, para 1.20

148 Q329-330. Action Fraud is the UK's national fraud and internet crime reporting centre – see www.actionfraud.police.uk/

149 Sixth Report of Session 2012–13, *Improving governance and best practice in workplace pensions*, HC 768-I, paras 76-77

79. In December 2014, the FCA published its *Retirement Income Market Study* and a *Thematic Review of Annuities Sales Practice*, which acknowledged the past poor practice of providers. The key findings of the reports included:

- Competition in the retirement income market is not working well for consumers;
- Many consumers are missing out on a higher income by not shopping around for an annuity and some do not purchase the best annuity for their circumstances;
- Consumers' tendency to buy from their existing pension provider weakens competition;
- The choices savers make are highly sensitive to how options are presented. Consumers may make different decisions even when the underlying choice remains the same, depending on how information is provided;
- Behavioural factors such as the tendency to under-estimate longevity, inflation and investment risk make savers vulnerable to being sold products which do not best meet their needs. [150]

80. The FCA's response to these very worrying findings is to carry out further monitoring before taking any action, which will take until mid-2015. We challenged them on this approach, given that the pension freedoms, with their accompanying risks, will be introduced in April. Chris Woolard, the Director of the Policy, Risk and Research Division, said that the FCA had to take an evidence-based approach. It was therefore necessary to check whether the examples of poor practice in annuity selling that the initial study had identified, where "the best outcome" was not achieved for the consumer, reflected a widespread problem, or were more isolated incidents. He agreed that rules needed to be put in place "that are enforceable by us" rather than relying on voluntary industry codes of conduct and emphasised that proposed action towards this was already "on the table". However, there would not be "an instant fix" and the rules themselves would certainly not be in place by April 2015. In the meantime, the guidance service (see below) would encourage people to shop around.[151]

81. The Minister acknowledged that "we have to put consumer protection at the heart of this" and this included "ensuring that the interaction with the provider is right." He accepted that it was "slightly frustrating" that the FCA's study would not be concluded until summer 2015, after the new freedoms had begun. However, he also saw advantages in this because it would enable the FCA to take "early action" if it became evident that problems were arising in the first period of the changes, rather than everything being decided and implemented before the initial impact of the changes was apparent.[152]

150 FCA, *TR14/20: Annuities sales practice*, December 2014; and FCA, *Retirement Income Market Study, Interim Report: Provisional findings and proposed remedies, MS14/3.2*, December 2014

151 Qq190–194

152 Q325

Pension Wise — the guidance service

82. In announcing the new pension flexibilities, the Government recognised that "in expanding the range of choices available, there is a corresponding need to help consumers navigate those choices, so that they can make good decisions which suit their needs and circumstances."[153] The Chancellor said in his Budget 2014 statement that "everyone who retires on these defined contribution pensions will be offered free, impartial, face-to-face advice on how to get the most from the choices they will now have." However, this was subsequently amended from "advice" to "guidance".[154] This change in terminology is significant. "Guidance" involves explaining the options to consumers and what the results of choosing those options might be, but providers of guidance are prohibited from offering an opinion about which option should be pursued. "Advice" is regulated by the FCA and requires the advisers who provide it to be registered and qualified. Advice must generally be paid for by the recipient.

83. In October 2014, the Treasury announced that Citizens Advice would provide a face-to-face guidance service, with telephone guidance provided by TPAS and an online service which will be designed by the Government.[155] In November 2014 the FCA published more details about the guidance service, including the "near final standards" for its delivery.[156] On 12 January 2015, the day of our evidence session with the Minister, the Treasury announced that the guidance service would be known as "Pension Wise".[157]

84. A requirement will be placed on providers that all communications to savers about retirement must include "a clear and prominent statement" about Pension Wise, including the purpose of the guidance and how to access it, and the different available channels. The Treasury has developed an "interim standardised letter" in cooperation with the pensions industry and the regulators, which will be included in retirement packs and other communications about accessing pension savings sent to savers by providers. This will carry the Pension Wise brand and has been "designed to ensure it effectively engages consumers". Pension Wise published draft guidelines for pension providers and schemes on "signposting to Pension Wise" on 16 February 2015. This included two versions of the standard signposting letter: one to be issued before the changes are implemented on 6 April and one to be used after this date.[158]

153 HM Treasury, *Freedom and choice in pensions*, Cm 8835, March 2014, p 30

154 HC Deb, 19 March 2014, col 793 ; HM Treasury, *Freedom and choice in pensions*, Cm 8835, March 2014, p 31, paras 4.12, 4.14

155 HMT press release, 18 October 2014, "Pensions guidance providers unveiled"

156 FCA, PS14/17: *Retirement Reforms and the Guidance Guarantee including feedback on CP 14/11*, November 2014

157 HMT press release, 12 January 2015, "Pension Wise unveiled"

158 Pension Wise, Signposting to Pension Wise: Guidelines, Draft v1.0, 16 February 2015; HMT, *Delivering pensions guidance: January 2015 update*, 12 January 2015

85. The FCA's "near final" standards for Pension Wise indicate that the service is intended to:

- Be impartial, consistent, of good quality and engaging;
- Create consumer trust and confidence in the guidance providers;
- Work for both contract-based and trust-based scheme members;
- Refer savers to specialist advice or information where appropriate;
- Provide the consumer with information about relevant options, and potential tax or debt obligations, and a record of the guidance session.

Standards are also set out on the skills, knowledge and expertise required of the guidance providers. The "optimum" length of the guidance session is expected to be 45 minutes, but this will be kept under review.[159]

86. The Government has made clear from the outset that the guidance service will be funded by businesses that "are likely to benefit from more engaged consumers". A levy will therefore be imposed on regulated financial services firms and those operating in the pensions market. This will be collected by the FCA which, together with the Treasury, will determine to which firms the levy will apply. Costs in the first year are expected to be higher than in subsequent years: the estimate for 2015–16 is £35 million. The Treasury will bear any costs above the levy in 2015–16 in the first instance, and then reclaim them in the subsequent year's levy. [160]

Limitations of the guidance service and the "second line of defence"

87. The PPI pointed out that there was a "wide degree of uncertainty" about how many people would take up the guidance service, with different surveys showing either a very large proportion of savers or a very small number. It noted that even the Treasury is not expecting "the majority" of people to take up the guidance offer.[161] In contrast, NAPF research with people over 55 had shown that only 15% would *not* use the service. [162] The FCA acknowledged that estimates ranged widely, between 2.5-3% and 90% take-up.[163]

88. A number of witnesses raised concerns about the limitations of the guidance service. Just Retirement, which is exclusively a provider of annuities, has argued for a "second line of defence" to be established which would require providers to go through a checklist of questions with savers before any pension saving is released to them. These questions would cover the "primary risk categories" where savers most frequently make poor decisions or

159 Q318. See also FCA, PS14/17: *Retirement Reforms and the Guidance Guarantee including feedback on CP 14/11*, November 2014

160 HMT, *Delivering pensions guidance: January 2015 update*, 12 January 2015; see also FCA, CP14/11: *Retirement reforms and the Guidance Guarantee*, July 2014, para 1.18-19

161 Q64

162 Q107

163 Qq212–213

inadvertent mistakes, including: paying too much tax; outliving assets or running out of money in retirement; purchasing uncompetitive products; and missing out on guaranteed annuity rates, enhanced rates for health conditions and provision for spouses.[164]

89. TPAS, which will be providing the telephony guidance service, identified similar concerns about the risks to savers and argued for something along the lines of the second line of defence. It believed that this was particularly important where savers were likely to be taking "irrevocable action" on the use of their pension saving, such as buying new, possibly untested, retirement products, because "the potential of the money evaporating is really high".[165] Ros Altmann argued that providers had a "duty of care" to savers "to make at least some cursory suitability checks before they sell them an irreversible life-long financial product" that was not appropriate for their needs.[166] The ABI has also supported the idea of a second line of defence.[167]

90. The FCA did not originally expect providers to ascertain whether their customers had made use of the guidance guarantee. Following consultation, it decided that it would place a requirement on providers to do this, and to encourage individuals to take up the guidance if they had not done so.[168] In oral evidence in December 2014, the FCA made clear that there would be a requirement on providers to explain the tax implications of savers' decisions about using pension saving and that specific annuities were available to take account of health conditions. At the time, the FCA witnesses did not seem convinced by arguments that a more robust second line of defence was necessary.[169] Chris Woolard said that it was not possible for the FCA to "stop fools behaving like fools". [170]

91. However, on 26 January 2015 the FCA wrote to the Committee Chair and to CEOs of pension companies to inform them that a "second line of defence" or "additional protection" requirement would be placed on providers. This means that, when savers contact the pension company to access their pension, "providers will be required to ask the consumer about key aspects of their circumstances that relate to the choice they are making" and to give "risk warnings". This will have to be delivered in "very direct and simple language". The rules will brought into force on a temporary basis from 6 April 2015 to ensure the additional protection is in place when the new flexibilities begin and will be set down in published rules. A decision will be made on whether to retain or modify the temporary rules as part of a wider consultation on the regulatory requirements on providers' interaction with customers.[171]

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164 Just Retirement (AEP0021) paras 20-27

165 Qq58, 61

166 Q37

167 Pensions Schemes Bill Committee, 23 October 2014, cols 111–2

168 FCA, PS14/17: *Retirement Reforms and the Guidance Guarantee including feedback on CP 14/11*, November 2014, 1.26, 4.10-4.11

169 Qq213, 218–220

170 Q208

171 FCA (AEP0043) supplementary evidence: Letter to the Chair of the Work and Pensions Committee, 26 January 2015. See also Letter from the FCA to CEOs, 26 January 2015

92. The FCA has asserted that this change in its approach was not the result of external pressure. David Geale, its Director of Policy, was quoted in the press a few days after the announcement as saying "We weren't told to do this, we chose to do it ourselves". He also argued that "the industry could have done this itself" rather than waiting for the regulator to impose a duty on it.[172]

93. **We welcome the concept of greater flexibility at retirement which is likely to have a positive effect on attitudes to pension saving, and ensures that no saver will now be obliged to purchase an annuity, the market for which, as we and many others have commented previously, has not been operating in the interests of savers. However, there will inevitably be an accompanying risk of savers making poor decisions or being exposed to potential fraud and scams. If there is early media coverage of savers suffering as a result, this could have a negative impact on pension saving, including on auto-enrolment. The freedoms will involve an increase in the number of decumulation options. This is a positive development but it places an even greater burden on savers to make the right decisions when they are often ill-equipped to do so. The guidance service, Pension Wise, is a welcome step, but will not be sufficient in itself to provide adequate protection for savers, particularly as the level of take-up is uncertain, and there is also some uncertainty about whether it will be fully operational from April 2015.**

94. ***The FCA has accepted, albeit rather late in the day, that additional protection for savers is required, in the form of the "second line of defence". We are pleased that a requirement will now be placed on providers from April 2015 to ask key questions about savers' circumstances before funds are released. However, the FCA has been too slow to act against poor treatment of pension savers by providers in the past and it will not decide on action in response to its own most recent findings on this until summer 2015. We make recommendations about changing the regulatory framework for pensions in the longer term later in this report. In the shorter term, we recommend that the new Government, and the new independent pension commission which we propose, assess whether the protections for savers that have been put in place so far are adequate, including those aimed at protecting savers from poor treatment by pension providers, as well as from scams and fraud. If weaknesses and loopholes are identified, urgent action needs to be taken as early in the new Parliament as possible. In the medium term, we recommend that responsibility for Pension Wise be transferred from the Treasury to DWP, so that the department responsible for pensions can oversee this important service.***

Default options on decumulation

95. Witnesses representing consumers argued that default options on decumulation were necessary so that inertia in coming to a decision about how best to use their pension pots did not cause detriment to savers. Age UK believed it was important that the system

172 Financial Times, 29 January 2015, "FCA denies political pressure over pension protection reforms"

"delivers for disengaged pension savers as well as for engaged ones, because we have auto-enrolled them into a scheme". [173] The NAPF went so far as to argue that default options should act as the first line of defence, backed up by the guidance service and the additional protection measures required of providers. Graham Vidler said that, rather than having a guidance service "that starts from nothing, we think the guidance should be an important way for people to check that the defaults being offered to them are the right thing for them, and to change them if necessary". [174]

96. Pension experts agreed about the need for defaults. The PPI argued that, because many people would not take up guidance or advice "we need really strong defaults, both in terms of how money is invested and the products that people go into". It was important to acknowledge that there was no perfect default option but, as a minimum, default options "should not, at any stage, give a very bad outcome in terms of the investment side". Standard Life agreed that default options should allow some growth and protect savers against volatility.[175]

97. The NAPF said that it was not yet clear what defaults would emerge from the new pension freedoms; one option might be a combination of flexible access to cash for a period, followed by an annuity purchase. But in reality it would vary between savers and schemes. However, over time, it was envisaged that trustees would set out "a small number of default pathways" which would offer "good but not necessarily optimal outcomes". However, the ABI pointed out that inertia and defaulting could not work in the same way as for AE: the wide range of decumulation options available meant that "some engagement with the process" from savers would be necessary. [176]

98. The FCA said that its role in this respect was to make sure that people who chose not to engage with their provider at the point when they could access their savings were "not unfairly disadvantaged by doing that—for example, they are not put into a high-charging scheme". The FCA also pointed out the risks arising from defaults: if the default option was to put someone's money into an annuity, their option to access their savings as cash would be removed; but if the default option was to provide the savings in cash, that could subject the individual to "a huge tax liability". Rather than trying to devise appropriate defaults, FCA witnesses believed that the solution was for providers to make every possible effort to contact the scheme member and encourage them to make a decision.[177]

99. The Minister was sceptical about whether it would be possible to work out realistic default options that were right for each individual. He also pointed out that it remained the duty of the trustees or IGCs, as long as the savings were not accessed, to ensure that the pots of people who cease to be "active investors" were still treated appropriately.[178]

173 Qq37, 60, 64-65

174 Q105

175 Qq37, 60, 64-65; Q142

176 Qq102-103, 105

177 Qq207-208, 216

178 Qq302, 332

Default funds and investment strategies

100. The new freedoms also have implications for the way default funds are managed and invested. The IMA highlighted that 90–95% of scheme members have their savings in default funds where default investment strategies are pursued.[179] The Minister agreed that the vast majority of pension saving is held in default funds and acknowledged that whether savers took proactive decisions about using their savings at age 55, and the decisions they came to, would affect the way pension schemes invested pension funds. He said that many pension schemes were consulting about their investment strategies in the light of the new freedoms because "the old way of locking into low-return assets at 55 or before just does not look right for most people [now]". However, he believed that individual schemes would know the characteristics of their own scheme members and vary the default investment strategy accordingly. [180]

101. The IMA argued that "there is never a single right answer in investment terms" but a way forward could be found by being clear about the objective to be achieved for members, the way the strategy was implemented and the way it was reviewed. This should be applicable to both the accumulation and decumulation phase and should be properly "joined up". [181]

102. The Institute and Faculty of Actuaries noted that, if fewer people choose to purchase annuities, "current investment strategies, particularly default strategies, may no longer be appropriate, as they were designed for most individuals purchasing annuities".[182] EEF said that scheme trustees were being asked to "up their game" on reviewing default strategies at a time when the evidence was not available on how employees were likely to respond to the changes.[183] While NOW: Pensions had been able to implement changes to its investment strategies to reflect the pension flexibilities "quickly and efficiently", it believed that other schemes might struggle to do this in time for the April 2015 changes.[184] NEST has undertaken a consultation on how its investment strategy might be changed to reflect the new pension freedoms.[185]

103. ***Pension schemes will need to adapt the investment strategies adopted for their default funds to take account of the new pension flexibilities. It will take some time for meaningful evidence to emerge on the decisions that savers are making about using their pension savings, particularly on whether use of annuities, or combinations of annuities with other products, remains significant. It may also be some time before it is clear how engaged savers become in making decisions on using their pension saving and the extent to which inertia means that pots are left in schemes rather than being accessed. We***

179 Q101

180 Qq310-312

181 Q102

182 Institute and Faculty of Actuaries (AEP0033), para 16

183 Q37

184 NOW: Pensions (AEP0026), para 18

185 NEST, *The future of retirement*, November 2014

recommend that the new independent pension commission which we propose assess the impact of the new flexibilities on default funds and investment strategies. It may also be necessary for it to consider the need for default decumulation options, if it becomes evident that large numbers of savers are not making decisions for themselves on this, despite the guidance available from Pension Wise and the additional input required from providers. In the meantime, we urge the FCA and TPR to monitor the behaviour of schemes closely to ensure action (or inaction) in this area is appropriate and not to the detriment of savers.

Improving pension information for savers

Pension statements

104. A considerable challenge which savers face in making decisions on how best to use their pension pots is that they often have several pension pots; and the information that they receive on pensions is complex and lengthy, and often fails to highlight the key points which are most important to the saver. To address the complexity of annual pension statements, the Treasury has stated that it intends to work with the pensions industry "to develop and test a short, simple, standardised product for communicating all the key information about an individual's pension pot". The FCA will then consider whether the issuing of a "standardised pension information statement" to savers should be made an explicit requirement in rules for providers.[186]

105. The Minister was sceptical of the value of providing too much detailed information on costs and charges in pension statements because of the difficulty for individuals in engaging meaningfully with this. He believed that it was for scheme trustees and IGCs to assess and compare charges and take action if they were regarded as too high. However, he agreed that savers needed information that was useful to them, which should be presented as clearly and consistently as possible.[187]

The "pensions dashboard"

106. A study by the FCA found that 43% of people who responded were unable to provide an estimate of the size of their total pension savings. The FCA and its predecessors have looked in the past at possible ways of providing comprehensive and consolidated information about all the pension saving an individual has, but it has previously been seen as too difficult to offer this. The FCA has now looked at this again, because it acknowledges that the number of pension pots people have is likely to increase, and the greater choice that savers will have under the new freedoms means that they will need more information and support to come to decisions about using their pension saving.

107. The FCA is now considering the introduction of a "pensions dashboard" along the lines of the one currently used in the Netherlands. The Netherlands dashboard has been

186 HMT, *Delivering pensions guidance: January 2015 update*, 12 January 2015

187 Qq282–284

shown to encourage consumer engagement and improve access to pension information. It informs every individual about all the pension pots they have built up in different schemes over their lifetime, including state pension entitlement. The FCA has recommended that a UK version be introduced "in the longer term" along similar lines to the Netherlands model.[188] The Minister said that he was very much in favour of the pensions dashboard idea, although he had doubts about how much information about historic pension pots it might be able to incorporate.[189]

108. ***The FCA has recommended the development of a "pensions dashboard" in the longer term, which would enable individuals to access consolidated information about all their pension saving in one place. We agree with the regulator that the case for a facility of this kind is even stronger, now that savers will be required to make decisions on how best to use their accrued pension saving, and many more people will have pension pots due to AE. We recommend that the next Government ensures that the regulators prioritise the introduction of a "pensions dashboard", which would ideally include both private and state entitlement, and make its use by providers a mandatory requirement.***

Increasing understanding of pensions

109. In our 2013 report, we noted that "lack of knowledge, understanding and financial literacy currently prevents people from being able to assess their retirement income needs and make sound decisions on pension saving". This weakness has become even more of a risk now that the choices available to individuals are so much broader and require their full engagement in making decisions about how best to use their pension saving. We recommended the Government take steps "to ensure that people have the best chance of reaching adulthood with the necessary tools to make informed decisions regarding saving for their retirement" including by encouraging schools to include retirement and pension saving as part of financial literacy education.[190] **We reiterate the importance of treating the development of people's understanding about, and confidence in dealing with, retirement saving as a lifelong learning issue, beginning at school, as part of financial literacy education.**

Age at which pension savings can be accessed

110. The Government's Response to the consultation in its *Freedom and Choice* document confirmed that, under the new system, people will be able to access their pension savings from age 55. The Government decided that it was appropriate initially to allow the new freedoms at age 55 because this is the age at which the current tax rules allow people to access their pension savings in some form, in most circumstances. However, the minimum

188 FCA, *Retirement Income Market Study: interim report*, 11 December 2014, pp 8, 71-2, 86, 88

189 Qq282, 294

190 Sixth Report of Session 2012–13, *Improving governance and best practice in workplace pensions*, HC 768, paras 85-92

age will increase to 57 in 2028, when the State Pension age increases to 67.[191] The Pensions Act 2014 established a framework of periodic reviews of whether State Pension age should be further increased. The review process will draw on reports from the Government Actuary's Department about life expectancy and on advice on wider factors from an appointed panel.[192]

111. We challenged the Minister on whether setting 55 as the minimum age at which pension saving could be accessed was sending out a mixed message to savers—that it was important to build up a substantial pension pot to provide a reasonable retirement income, but on the other hand people could expect to be able to take their pension at age 55, 10 years earlier than the current State Pension age. His view was that it was important to remember that 55 was the *earliest* age at which pension savings could be accessed: it was unlikely to be the *typical* age because most people would realise that they had "not got anywhere near enough money to stop work", or to spend their pension pot, at 55. He believed the typical person would go on working and saving. He agreed that there had been "a lot of chatter" about taking advantage of the freedoms at age 55, but believed that this had been useful in engaging people's attention in pension saving and had made it more likely that people would save, which was a "fantastic outcome".[193]

112. ***It is important that allowing people to access their pension saving at 55 does not create unrealistic expectations about the age at which people will be able to afford to stop working, and the length of time individuals will need to continue to save in order to build up a meaningful pension pot. An increase to age 57 is already planned for 2028 when State Pension age rises to 67. It seems sensible to continue this linkage. The Government has established a review process for State Pension age which includes advice from an expert panel. We recommend that the new independent pension commission, which we propose, coordinate its work with that of the expert panel looking at State Pension age, so that decisions about further changes to State and private pension arrangements are coherent and complementary. Our view is that, given the significant tax relief provided to pensions, increased longevity, and the importance of ensuring people do not underestimate the income needed in retirement, the minimum age at which people can access their pension saving, except on ill health grounds, should rise to five years below the State Pension age.***

191 HM Treasury, *Freedom and choice in pensions: government response to the consultation*, July 2014, Cm 8901, p 6. The increase will apply to all pension schemes apart from those in the public sector that will not link their normal pension age to State Pension age from 2015 (Armed Forces, Firefighters, and Police).

192 Pensions Act 2014, section 27

193 Qq312-313

7 Shared risk and collective schemes

113. In the current workplace pension system, there are only two types of pension scheme: Defined Benefit (DB) and Defined Contribution (DC). In DB schemes, employers bear the entire risk arising from increased longevity of scheme members and lower investment returns; in DC schemes, employees bear the entire risk. The Government decided to introduce a new type of scheme which would allow risk to be shared more evenly between employers and employees than the current models. This was initially known as "Defined Ambition" but is now referred to as "shared risk".[194] The Pension Schemes Act 2015, which received Royal Assent on 3 March 2015, provides for the necessary legislative changes to introduce shared risk pension schemes.[195]

114. The Act also makes provision for collective schemes (previously referred to as Collective Defined Contribution) as one form of risk-sharing model. Collective schemes do not share risk between employer and employee in the same way as other risk-sharing schemes; instead, pension pots are pooled and risk is shared between scheme members. Members who have retired are effectively being subsidised by active members (known as inter-generational risk-sharing). Benefits in collective schemes are not as certain as benefits in DB schemes (where members receive a proportion of their salary for each year they contribute). Nor are they as uncertain as in DC schemes, where the final benefit is dependent on market performance during the savings period, the member's choice of retirement income products, and the rates on offer for these.[196]

115. The CBI and EEF did not believe that there was much appetite for shared risk or collective schemes as employers were more likely to be looking to reduce their pension liabilities and move away from DB schemes. However, witnesses agreed that there would be interest and value in exploring the "pooling and aggregating" of smaller schemes.[197] Standard Life pointed out that employers with DB schemes might have seen the new types of scheme as attractive 10 years ago but many have since moved to DC. It believed that employers who had already "achieved the benefits of a move away from underwriting risk" are unlikely to be willing to adopt further significant changes in the pension schemes they offer. This was likely to mean that the number of employers willing to participate, and the potential to achieve the necessary scale, would be reduced.[198] Scottish Widows identified a similar lack of demand for these new types of schemes.[199]

116. The Minister believed that the ending of contracting-out, which is part of the reforms accompanying the introduction of the new State Pension in April 2016, was "one of the obvious triggers" for introducing the new types of pension scheme; some employers were

194 DWP, *Reinvigorating workplace pensions*, Cm 8478, November 2012, Chapter 3

195 HC Deb, 3 March 2015, col 811 and Pension Schemes Act 2015

196 DWP, *Reshaping workplace pensions for future generations*, Cm 8710, November 2013, Chapter 5

197 Qq38-39

198 Standard Life plc (AEP0012), para 42

199 Scottish Widows (AEP0022), para 7.3

likely to move from DB schemes to shared risk as a result. He accepted that collective schemes were a "niche interest" but thought that there was "a lot of enthusiasm" for them amongst those who were interested. Once the legal framework was in place, employers would have a better idea about what these new types of schemes could offer.[200]

117. ***We welcome the regulatory changes that enable the use of shared risk and collective benefit schemes. We consider that these do have the potential to provide more certainty and confidence for savers about their retirement income. Sadly, however, we found little interest in developing such schemes. In reality, only small numbers of employees are likely to be affected by these schemes, at least at first. In contrast, auto-enrolment and the introduction of the new pension flexibilities have more immediate implications for millions of people and significant challenges remain in fully implementing both of these reforms. We therefore recommend that DWP ensures that resources are not diverted towards the development of shared risk schemes until AE is fully rolled out, and effective operation of the new flexibilities is properly established.***

200 Q344. The implications of the ending of contracting-out were assessed in the Committee's pre-legislative scrutiny of the proposals for the new (single-tier) State Pension. See Fifth Report from the Work and Pensions Committee, Session 2012–13, *The Single-tier State Pension: Part 1 of the draft Pensions Bill*, HC 1000, April 2013, and *the Government Response*, Cm 8620, May 2013

8 Regulatory framework

The case for a revised regulatory approach

118. We recommended in our 2013 Report that the Government reassess whether the existing pensions regulatory framework was working effectively. In simple terms, responsibility is currently divided between The Pensions Regulator (TPR) which oversees trust-based pension schemes, and the Financial Conduct Authority (FCA—previously the Financial Services Authority (FSA)) which regulates contract-based schemes (although the FCA is also responsible for some aspects of provider activities in trust-based schemes).[201]

119. In 2013, we questioned the level of resources which the FSA (now FCA) was able to devote to pensions regulation, given the other demands arising from wider financial services and banking regulation. We said that we were "not convinced that the FCA is the appropriate body to regulate contract-based pension schemes." We asked the Government to consider whether a single body with sole responsibility for regulating workplace pensions should be established.[202]

120. The FCA and TPR view in the current inquiry was that they were both "a creature of the statute, as opposed to something that creates it", so they would work with whatever regulatory structure the Government put in place. However, they argued that, wherever the lines were drawn in financial services regulation, there would always be boundaries where pensions meet investments, taxation and other Treasury responsibilities. Good relationships and effective coordination between the responsible bodies were therefore the key to avoiding gaps and providing a seamless service for users. Stephen Soper of TPR acknowledged that, if you were starting from scratch you probably would not set up the system as it currently operated, but starting with a blank page would not necessary produce a better outcome.[203]

121. In response to our 2013 report, the Government stated that it did not believe the timing was right to change the regulatory structure: the FCA had only recently been created and AE had only recently begun. However, it accepted that work was necessary to ascertain whether it was possible for the regulators to be more closely aligned and whether there was a need for further legislative requirements. [204]

122. It was evident during proceedings on the Pension Schemes Bill in autumn 2014 that the Government's position had shifted slightly.[205] In oral evidence to us in January 2015, the Minister clarified his position: "mucking about with regulators" in the middle of the AE process and with the new pension freedoms about to begin "does not feel like the right

201 Sixth Report of Session 2012–13, *Improving governance and best practice in workplace pensions*, HC 768, Chapter 6. See also Q169

202 Sixth Report of Session 2012–13, *Improving governance and best practice in workplace pensions*, HC 768-I, Chapter 6

203 Qq148–153

204 First Special Report, Session 2013–14, Improving governance and best practice in workplace pensions: Government Response to the Committee's Sixth Report of Session 2012–13, HC 485

205 HC Deb 2 September 2014, cols 202-3 and Pension Schemes Bill Committee, 28 October 2014, col 176

thing to do"; however, "my experience of the past 12 months makes me think it is well worth looking at".[206] The Minister also raised the question of whether pensions policy is "too fragmented" within government, being spread across DWP, the Treasury and the Cabinet Office (which is responsible for public service pensions). His view was that there was a "strong case" for bringing this together in one department, which would also make the job of Pensions Minister "an awful lot easier".[207]

123. In 2013, we recommended that, if the FCA remained responsible for contract-based pensions, it should "adopt a pensions-specific and proactive regulatory strategy and set up a well-resourced team dedicated solely to regulating contract-based pension schemes."[208] In oral evidence to this inquiry, the FCA said that it now had 45 people working solely on pensions and "around 100 staff from time to time […] deployed on thinking about pensions-related issues"; and that there was the ability to move resources to where they were most needed. When asked whether there was sufficient senior management focus on pensions within the FCA, Christopher Woolard said "there probably is […] broadly the answer is yes". [209] It was also notable that neither of the FCA witnesses had "pensions" in their job title.

124. **In 2013, we expressed concerns about the FCA's ability to regulate pensions effectively and recommended that the Government consider establishing a single pensions regulator. Nothing we have heard in our current inquiry has allayed our concerns about the FCA's focus and expertise on pensions. The comment from FCA witnesses, previously cited, that it cannot "stop fools acting like fools" was particularly worrying and does not inspire confidence in the FCA's approach to pension savers. We are pleased that the Minister's position on a single regulator is changing, particularly as there seems to us to be an even stronger case for this now, because of the greater potential for saver detriment under the new flexibilities. We accept that there would be some costs and disruption to moving to a single regulator and that difficulties with boundaries may still occur to some extent. However, we believe these factors are outweighed by clarity for savers, employers and the pensions industry. A single regulator would also be better placed to look across the pensions landscape, from the start of saving to the point at which funds can first be accessed, and on through the decumulation process as it continues through retirement.**

125. ***We recommend that the next Government consider the merits of establishing a single regulator covering the whole remit of pension saving, drawing on detailed analysis of the current regulatory framework carried out by the new independent pension commission which we propose. The Pensions Minister also suggested that pensions policy is currently too fragmented across government and believed that there was a strong case for bringing the different policy responsibilities together in one government department. We agree that***

206 Q346

207 Q272

208 Sixth Report, Session 2012–13, Improving governance and best practice in workplace pensions, HC 768-I, Summary and para 104

209 Qq159–160, 166-168

this is a sensible proposal for the next Government to consider, and believe that it will strengthen the case for a single regulator even further.

Conclusions and recommendations

In this list, conclusions are set out in plain type and recommendations, to which the Government is required to respond, are set out in *italic type*.

Reviewing auto-enrolment and advising on future pension policy

1. *We recommend that the next Government take steps to establish an independent pension commission at an early date after the General Election and certainly by July 2015. Its remit should be: to review AE implementation to date; to advise on necessary changes and adjustments to AE; to consider all the implications of the pension flexibilities introduced from April 2015; and to advise government on consequent amendments required to existing pension legislation, and on development of future pension policy. The new commission should be similar in format to the 2005–06 Pensions (Turner) Commission, with a chair and two or three members only, but it should involve the widest range of stakeholders in its deliberations, including the pensions industry, employers, employees and their representatives, pension experts and consumer representatives. It should coordinate its work with the Government's planned independently-led review of State Pension age. If the new Government does not accept that a new pension commission is required, it will need to tackle the range of issues raised in this report itself, as a matter of urgency.* (Paragraph 18)

Future challenges for auto-enrolment

Measuring effectiveness

2. *The low opt-out rate for AE to date is an early indicator of the policy's effectiveness in enrolling people into workplace schemes. However, it is not a meaningful measure of the effectiveness of AE policy in the longer term. We recommend that DWP and The Pensions Regulator (TPR) monitor and report on the number of employees leaving AE schemes after the initial opt-out period ("attrition rates") so that levels of ongoing participation in pensions and the impact of increases in minimum contributions can be assessed. The new independent pension commission which we propose should advise on how the effectiveness of AE can be measured in the longer term.* (Paragraph 22)

Minimum contribution rate

3. *We continue to believe that minimum contribution rates will need to increase beyond 8% if AE is to be effective in ensuring that adequate retirement income levels are achieved. We recommend that the new independent pension commission which we propose (or the new Government) undertake a consultation on when and how minimum contributions should be increased, as soon as possible after the General Election, with a view to implementing changes before the end of the next Parliament. This is likely to require a reassessment of the definition of what constitutes "adequacy" of retirement income a decade on from the previous Pensions Commission's work on this.* (Paragraph 25)

Eligibility and exclusions

4. *The AE annual earnings threshold currently excludes a significant number of low-paid workers. We accept that AE needs to be limited to those who will benefit; and that the State Pension is likely to produce an adequate replacement rate in retirement for workers who earn at low levels throughout their working lives. However, it is not clear how many individuals will be affected by the earnings threshold, particularly those in multiple, low-paid jobs, nor whether their exclusion from AE is more likely to be over the short or longer term. We agree with the Minister that more research on this is necessary. We recommend that the new independent pension commission which we propose give early consideration to whether the AE annual earnings trigger needs to be adjusted, and to how those who are currently excluded from AE, particularly self-employed people and those who are in multiple low-paid jobs over longer periods, might be supported to make adequate provision for their retirement.* (Paragraph 30)

Extension to smaller employers

5. The challenges associated with the roll-out of AE to smaller employers are significant, given that small businesses have limited resources and time to devote to the process, and less experience in pensions and access to specialist advice than larger employers. It is important that small employers are fully supported to comply with the obligations that AE places on them and that the burden on them is kept to a minimum by making the process as straightforward as possible. TPR appears to have taken this on board to date, particularly in relation to simplifying communications and offering a “directed journey” which removes many of the complications from the enrolment process. (Paragraph 37)

6. *We recommend that the next Government take the lead in ensuring that support for smaller employers continues to be coordinated across regulators and providers. The intermediaries which small employers regularly use, such as accountants, bookkeepers and payroll providers, will also have an important role to play and should be used as an effective resource by ensuring that they are properly connected to the process. The new independent pension commission which we propose should assess progress with AE by smaller employers at an early date and advise on further support and adjustments which it identifies as being necessary to complete AE implementation smoothly.* (Paragraph 38)

Automatic transfers

7. *We acknowledge that a system for automatic transfers is essential for auto-enrolment to work effectively. However, progress on developing a satisfactory process has been slow and a significant number of pension providers remain to be convinced that “pot follows member” is the right solution. Publication in February 2015 of the latest detailed plans for automatic transfers is a welcome step, although implementation is still not scheduled to begin until October 2016. We recommend that the next Government confirm the plans for automatic transfers at an early date. DWP will also* *need to continue to work hard to persuade the pensions industry of the merits of pot follows member. This will be assisted by more rapid progress with the development of workable and robust IT solutions, particularly in relation to scheme member identification, in cooperation with pension providers.* (Paragraph 45)

Scheme governance and charges

8. We welcome the progress made by the Government and the pensions industry in reducing charges and improving governance since our 2013 report. The introduction of the 0.75% charge cap for auto-enrolment default funds is a significant step. However, ensuring scheme quality and value for money for savers is of increasing importance as AE brings millions more individuals into pension saving for the first time, and the complexity of the pensions market increases. (Paragraph 64)

9. *The challenges of addressing high charges and poor governance in older ("legacy") pension schemes and of determining value for money in relation to transaction costs are yet to be tackled effectively. We recommend that the new independent pension commission which we propose address these issues as a priority. It will also need to assess the impact of the charge cap and advise on whether it should be further reduced; and work with the pensions industry to develop effective solutions to increase the transparency of all pension charges. We also recommend that the new commission or the next Government consider the level of charges appropriate in the decumulation period and for drawdown schemes.* (Paragraph 65)

New pension flexibilities

10. *It is unlikely that the full range of decumulation options envisaged by the Government will be in place when the new pension freedoms begin in April 2015. Some may be impractical even in the longer term, particularly "cashpoint drawdown" (which would allow savers to use their pension pots like bank accounts). Many schemes will not be in a position to offer the new options, at least at first, and savers will therefore have to move their pots to another scheme to benefit from the flexibilities. Raising expectations that cannot be satisfied could lead to saver disappointment. Annuities are still likely to be the best option for many individuals but they will need to become more flexible—for example by offering fixed term rather than lifetime products, or combinations of annuity, lump sum and drawdown products. We recommend that the new pension commission which we propose assess the impact of the reforms on the range, suitability and accessibility of retirement products and advise on any necessary interventions if the market is not operating in the best interests of pension savers.* (Paragraph 75)

Protecting savers

11. We welcome the concept of greater flexibility at retirement which is likely to have a positive effect on attitudes to pension saving, and ensures that no saver will now be obliged to purchase an annuity, the market for which, as we and many others have commented previously, has not been operating in the interests of savers. However, there will inevitably be an accompanying risk of savers making poor decisions or being exposed to potential fraud and scams. If there is early media coverage of savers suffering as a result, this could have a negative impact on pension saving, including on auto-enrolment. The freedoms will involve an increase in the number of decumulation options. This is a positive development but it places an even greater burden on savers to make the right decisions when they are often ill-equipped to do so. The guidance service, Pension Wise, is a welcome step, but will not be sufficient in itself to provide adequate protection for savers, particularly as the level of take-up is uncertain, and there is also some uncertainty about whether it will be fully operational from April 2015. (Paragraph 93)

12. *The FCA has accepted, albeit rather late in the day, that additional protection for savers is required, in the form of the "second line of defence". We are pleased that a requirement will now be placed on providers from April 2015 to ask key questions about savers' circumstances before funds are released. However, the FCA has been too slow to act against poor treatment of pension savers by providers in the past and it will not decide on action in response to its own most recent findings on this until summer 2015. We make recommendations about changing the regulatory framework for pensions in the longer term later in this report. In the shorter term, we recommend that the new Government, and the new independent pension commission which we propose, assess whether the protections for savers that have been put in place so far are adequate, including those aimed at protecting savers from poor treatment by pension providers, as well as from scams and fraud. If weaknesses and loopholes are identified, urgent action needs to be taken as early in the new Parliament as possible. In the medium term, we recommend that responsibility for Pension Wise be transferred from the Treasury to DWP, so that the department responsible for pensions can oversee this important service.* (Paragraph 94)

Default investment strategies and decumulation options

13. *Pension schemes will need to adapt the investment strategies adopted for their default funds to take account of the new pension flexibilities. It will take some time for meaningful evidence to emerge on the decisions that savers are making about using their pension savings, particularly on whether use of annuities, or combinations of annuities with other products, remains significant. It may also be some time before it is clear how engaged savers become in making decisions on using their pension saving and the extent to which inertia means that pots are left in schemes rather than being accessed. We recommend that the new independent pension commission which we propose assess the impact of the new flexibilities on default funds and investment strategies. It may also be necessary for it to consider the need for default decumulation options, if it becomes evident that large numbers of savers are not making decisions for themselves on this, despite the guidance available from Pension Wise and the additional input required from providers. In the meantime, we urge the FCA and TPR to monitor the behaviour of schemes closely to ensure action (or inaction) in this area is appropriate and not to the detriment of savers.* (Paragraph 103)

The "pensions dashboard"

14. *The FCA has recommended the development of a "pensions dashboard" in the longer term, which would enable individuals to access consolidated information about all their pension saving in one place. We agree with the regulator that the case for a facility of this kind is even stronger, now that savers will be required to make decisions on how best to use their accrued pension saving, and many more people will have pension pots due to AE. We recommend that the next Government ensures that the regulators prioritise the introduction of a "pensions dashboard", which would ideally include both private and state entitlement, and make its use by providers a mandatory requirement.* (Paragraph 108)

Increasing understanding of pensions

15. We reiterate the importance of treating the development of people's understanding about, and confidence in dealing with, retirement saving as a lifelong learning issue, beginning at school, as part of financial literacy education. (Paragraph 109)

Age at which pension saving can be accessed

16. *It is important that allowing people to access their pension saving at 55 does not create unrealistic expectations about the age at which people will be able to afford to stop working, and the length of time individuals will need to continue to save in order to build up a meaningful pension pot. An increase to age 57 is already planned for 2028 when State Pension age rises to 67. It seems sensible to continue this linkage. The Government has established a review process for State Pension age which includes advice from an expert panel. We recommend that the new independent pension commission, which we propose, coordinate its work with that of the expert panel looking at State Pension age, so that decisions about further changes to State and private pension arrangements are coherent and complementary. Our view is that, given the significant tax relief provided to pensions, increased longevity, and the importance of ensuring people do not underestimate the income needed in retirement, the minimum age at which people can access their pension saving, except on ill health grounds, should rise to five years below the State Pension age.* (Paragraph 112)

Shared risk and collective schemes

17. *We welcome the regulatory changes that enable the use of shared risk and collective benefit schemes. We consider that these do have the potential to provide more certainty and confidence for savers about their retirement income. Sadly, however, we found little interest in developing such schemes. In reality, only small numbers of employees are likely to be affected by these schemes, at least at first. In contrast, auto-enrolment and the introduction of the new pension flexibilities have more immediate implications for millions of people and significant challenges remain in fully implementing both of these reforms. We therefore recommend that DWP ensures that resources are not diverted towards the development of shared risk schemes until AE is fully rolled out, and effective operation of the new flexibilities is properly established.* (Paragraph 117)

Regulatory framework

18. In 2013, we expressed concerns about the FCA's ability to regulate pensions effectively and recommended that the Government consider establishing a single pensions regulator. Nothing we have heard in our current inquiry has allayed our concerns about the FCA's focus and expertise on pensions. The comment from FCA witnesses, previously cited, that it cannot "stop fools acting like fools" was particularly worrying and does not inspire confidence in the FCA's approach to pension savers. We are pleased that the Minister's position on a single regulator is changing, particularly as there seems to us to be an even stronger case for this now, because of the greater potential for saver detriment under the new flexibilities. We accept that there would be some costs and disruption to moving to a single regulator and that difficulties with boundaries may still occur to some extent. However, we believe these factors are outweighed by clarity for savers, employers and the pensions industry. A single regulator would also be better placed to look across the pensions landscape, from the start of saving to the point at which funds can first be accessed, and on through the decumulation process as it continues through retirement. (Paragraph 124)

19. *We recommend that the next Government consider the merits of establishing a single regulator covering the whole remit of pension saving, drawing on detailed analysis of the current regulatory framework carried out by the new independent pension commission which we propose. The Pensions Minister also suggested that pensions policy is currently too fragmented across government and believed that there was a strong case for bringing the different policy responsibilities together in one government department. We agree that this is a sensible proposal for the next Government to consider, and believe that it will strengthen the case for a single regulator even further.* (Paragraph 125)

Formal Minutes

Wednesday 4 March 2015

Members present:

Dame Anne Begg, in the Chair

Sheila Gilmore
Glenda Jackson
Paul Maynard
Nigel Mills
Anne Marie Morris

Draft report (*Progress with automatic enrolment and pension reforms*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 125 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Fourth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Wednesday 18 March at 9.15 am.

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the Committee's inquiry page at www.parliament.uk/workpencom.

Wednesday 19 November 2014

Question number

Marcus Mason, Policy Manager, Employment and Skills, British Chambers of Commerce, **Jim Bligh**, Head of Public Services, Confederation of British Industry, **Judith Hogarth**, Interim Head of Employment and Pensions, EEF (the manufacturers' organisation), **Mike Cherry**, National Policy Chairman, Federation of Small Businesses, and **Dr Ros Altmann** Q1-40

Jane Vass, Head of Policy, Age UK, **Rachael Badger**, Head of Policy Research for Families, Welfare and Work, Citizens Advice, **Chris Curry**, Director, Pensions Policy Institute, **Michelle Cracknell**, Chief Executive, The Pensions Advisory Service, and **Tim Sharp**, Pensions Policy Officer, Trades Union Congress Q41-66

Monday 1 December 2014

Otto Thoresen, Director General, Association of British Insurers, **Jonathan Lipkin**, Director of Public Policy, Investment Management Association, and **Graham Vidler**, Director of External Affairs, National Association of Pension Funds Q67-108

Adrian Boulding, Pensions Strategy Director, Legal & General, and Chairman, Pension Quality Mark, **Tim Jones**, Chief Executive Officer, National Employment Savings Trust, **Morten Nilsson**, Chief Executive, NOW: Pensions, **Patrick Heath-Lay**, Chief Executive Officer, People's Pension, and **Jamie Jenkins**, Head of Pensions Strategy, Standard Life Q109-145

Wednesday 17 December 2014

Christopher Woolard, Director, Policy, Risk and Research Division, and **David Geale**, Director of Policy, Financial Conduct Authority, and **Stephen Soper**, Interim Chief Executive, and **Charles Counsell**, Executive Director, Automatic Enrolment, The Pensions Regulator Q146-237

Monday 12 January 2015

Rt Hon Steve Webb MP, Minister for Pensions, Department for Work and Pensions Q238-357

Published written evidence

The following written evidence was received and can be viewed on the Committee's inquiry web page at www.parliament.uk/workpencom. AEP numbers are generated by the evidence processing system and so may not be complete.

1 Age UK (AEP0029)
2 Aon Hewitt (AEP0005)
3 Association of British Insurers (AEP0030)
4 Association of Convenience Stores (AEP0009)
5 Aviva (AEP0006)
6 B&Ce The People's Pension (AEP0020 & AEP0041)
7 British Private Equity and Venture Capital Association (AEP0004)
8 Buck Consultants Ltd (AEP0010)
9 Business in the Community (AEP0025)
10 Chartered Institute of Personnel and Development (AEP0016)
11 Department for Work and Pensions (AEP0027)
12 Financial Conduct Authority (AEP0038 & AEP0043)
13 Forum of Private Business (AEP0035)
14 HISL Ltd (AEP0001)
15 Institute and Faculty of Actuaries (AEP0033)
16 Investment Management Association (AEP0042)
17 Just Retirement (AEP0021)
18 Mercer Ltd (AEP0019)
19 National Association of Pension Funds (AEP0031)
20 NEST Corporation (AEP0034)
21 Now: Pensions (AEP0026)
22 Partnership Assurance Group plc (AEP0028)
23 Pensions Policy Institute (AEP0003)
24 Prudential (AEP0040)
25 Scottish Life/Royal London (AEP0007)
26 Scottish Widows (AEP0022)
27 Shareaction (AEP0017)
28 Siemens plc (AEP0018)
29 Standard Life plc (AEP0012)
30 The Pensions Advisory Service (AEP0037)
31 The Pensions Management Institute (AEP0011)
32 The Pensions Regulator (AEP0024)
33 The Society of Pension Professionals (AEP0015)
34 Tax Incentivised Savings Association (AEP0014)
35 Trades Union Congress (AEP0008)
36 Vocalink (AEP0002)
37 Which? (AEP0023)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the Committee's website at www.parliament.uk/workpencom.

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2014–15

First Report	Employment and Support Allowance and Work Capability Assessments	HC 302 (Cm 8967)
Second Report	Improving Access to Work for disabled people	HC 481
Third Report	Appointment of the Pensions Ombudsman and the Pension Protection Fund Ombudsman	HC 963
First Special Report	Monitoring the performance of the Department for Work and Pensions in 2012-13: Government Response to the Committee's Third Report of Session 2013–14	HC 394
Second Special Report	Universal Credit implementation: monitoring DWP's performance in 2012–13: Government Response to the Committee's Fifth Report of Session 2012–13	HC 426
Third Special Report	Fraud and error in the benefits system: Government Response to the Committee's Sixth Report of Session 2013–14	HC 627

Session 2013–14

First Report	Can the Work Programme work for all user groups?	HC 162 (HC 627)
Second Report	The role of Jobcentre Plus in the reformed welfare system	HC 479 (HC 1210)
Third Report	Monitoring the performance of the Department for Work and Pensions in 2012–13	HC 1153 (HC (14-15)394)
Fourth Report	Support for housing costs in the reformed welfare system	HC 720
Fifth Report	Universal Credit implementation: monitoring DWP's performance in 2012–13	HC 1209 HC (14-15)426)
Sixth Report	Fraud and error in the benefits system	HC 1082 (HC (14-15)627)
First Special Report	Improving governance and best practice in workplace pensions: Government Response to the Committee's Sixth Report of Session 2012–13	HC 485
Second Special Report	Can the Work Programme work for all user groups? Government Response to the Committee's First Report of Session 2013-14	HC 627

Third Special Report	Role of Jobcentre Plus in the reformed welfare system: Government Response to the Committee's Second Report of Session 2013–14	HC 1210

Session 2012–13

First Report	Appointment of the Chair of the Social Security Advisory Committee	HC 297
Second Report	Youth Unemployment and the Youth Contract	HC 151 (HC 844)
Third Report	Universal Credit implementation: meeting the needs of vulnerable claimants	HC 576 (Cm 8537)
Fourth Report	Lifting the restrictions on NEST	HC 950
Fifth Report	The Single-tier State Pension: Part 1 of the draft Pensions Bill	HC 1000 (Cm 8620)
Sixth Report	Improving governance and best practice in workplace pensions	HC 768 (HC 485)
First Special Report	Government support towards the additional living costs of working-age disabled people	HC 105
Second Special Report	Automatic enrolment in workplace pensions and the National Employment Savings Trust: Government Response to the Committee's Eighth Report of Session 2010–12	HC 154
Third Special Report	Youth Unemployment and the Youth Contract: Government Response to the Committee's Second Report of Session 2012–13	HC 844

Session 2010–12

First Report	Youth Unemployment and the Future Jobs Fund	HC 472 (HC 844)
Second Report	Changes to Housing Benefit announced in the June 2010 Budget	HC 469 (HC 845)
Third Report	Appointment of the Chair of the Social Security Advisory Committee	HC 904
Fourth Report	Work Programme: providers and contracting arrangements	HC 718 (HC 1438)
Fifth Report	The Government’s proposed child maintenance reforms	HC 1047 (HC 1727)
Sixth Report	The role of incapacity benefit reassessment in helping claimants into employment	HC 1015 (HC 1641)
Seventh Report	Government support towards the additional living cost of working-age disabled people	HC 1493
Eighth Report	Automatic enrolment in workplace pensions and the National Employment Savings Trust	HC 1494
First Special Report	The Child Maintenance and Enforcement Commission	HC 507
Second Special Report	Management and Administration of Contracted Employment Programmes	HC 508
Third Special Report	Local Housing Allowance: Government Response to the Committee's Fifth Report of Session 2009-10	HC 509
Fourth Special Report	Changes to Housing Benefit announced in the June 2010 Budget: Government Response to the	HC 845

	Committee's Second Report of Session 2010–11	
Fifth Special Report	Youth Unemployment and the Future Jobs Fund: Government Response to the Committee's First Report of Session 2010-11	HC 844
Sixth Special Report	Work Programme: providers and contracting arrangements: Government Response to the Committee's Fourth Report of Session 2010-12	HC 1438
Seventh Special Report	The role of incapacity benefit reassessment in helping claimants into employment: Government Response to the Committee's Sixth Report of Session 2010–12	HC 1641
Eighth Special Report	The Government's proposed child maintenance reforms: Government Response to the Committee's Fifth Report of Session 2010–12	HC 1727