Understanding the impact of 'pot for life' proposals

A WPI Economics report for the ABI

Joe Ahern – Head of Policy Consulting - joe.ahern@wpieconomcs.com

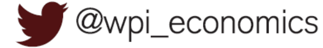
Matthew Oakley – Director – Matthew@wpieconomics.com

Julia Wyjadlowska – Senior Consultant - julia.wyjadlowska@wpieconomics.com

Marc Brazzill – Data Insights Consultant – Marc.Brazzill@wpieconomics.com

28/03/2024

www.wpieconomics.com

info@wpieconomics.com

@wpi_economics

WPI Economics Limited, registered address 28 Church Road, Stanmore, Middlesex, England, HA7 4XR, is registered as a limited company in England and Wales under company number 10086986.

ABOUT WPI ECONOMICS

Founded in 2016, WPI Economics makes an impact through economics that people understand, policy consulting and data insight. We work with a range of organisations – from FTSE 100 companies, to SMEs, charities, central and local government – to help them influence and deliver better outcomes through improved public policy design and delivery. Our focus is on important social, environmental and economic policy debates, such as the future of the green economy, productivity and growth, levelling up and mental health. We are driven by a desire to make a difference, both through the work we do and by taking our responsibilities as a business seriously. We are a Living Wage employer, currently working towards BCorp accreditation.

Disclaimer and legal

This report has been produced by WPI Economics, an independent economics, policy and data insight consultancy. The views expressed in the report are based on independent research and represent solely the views of the authors. They are provided for informative purposes only. Whilst we undertake every effort to ensure that the information within this document is accurate and up to date, neither WPI Economics nor the report's authors accept any liability for direct, implied, statutory, and/or consequential loss arising from the use of this document or its contents.

Contents

Executive summary 3
1. Introduction and context 5
2. Impact of the reforms on employers 7
3. How member choice could change the pensions market 16
4. Impact on investment 25
5. Summary and conclusion 27
Annex 28
Polling 28

Executive summary

Proposals to introduce member choice and stapling in workplace pensions in the UK have the potential to profoundly change the market for savers, employers, and providers. This report brings together a range of evidence to set out what this could mean in practice, recognising the significant uncertainty around policy design and implementation.

Our research found that:

The role of the employer completely changes under member choice and stapling

Drawing on a survey of 1,002 employers, we demonstrate that these reforms risk breaking the link between employers and their employees' pensions, as well as creating a significant administrative burden on employers. The survey found that:

- At present, over three quarters of employers were confident that their current scheme is managing their employees' pensions effectively (77%).
- 57% of employers said that, under member choice and stapling, their interest in the quality of the workplace pension scheme that they choose for the employees who remain would be reduced.
- 63% of employers are worried that the proposed reforms will increase their payroll provider costs.
- 65% of employers stated that, as a result of the reforms, they would find it difficult to assess the quality of the different pension schemes the company would now be contributing to.
- 62% of employers are worried that the reforms would lead to their employees getting worse pension outcomes compared to just 10% who disagreed.
- 61% of employers recognised the potential of the reforms to give employees the freedom to choose a pension that works for them.
- 28% of employers said that they estimate having to increase their staff time dedicated to activities related to workplace pensions by more than 5 hours per month following the reform. Based on all additional hours worked, and the staff carrying out these activities being paid a median salary, this is equivalent to an **additional salary expenditure on activities related to workplace pensions of £550 million per year.**

A retail market based on member choice could be bad for lower income savers across the board, as well as many switchers

With member choice, demand side pressure in the pensions market would come from individuals rather than employers, creating a retail pensions market based on individual pension choices. Evidence from markets for other retail financial products shows that:

- **A minority of savers are likely to engage under member choice** – we would expect 5 – 8% to switch in the initial years of the policy, based on examples from non-workplace pensions,

current levels of access to advice, and data on who consolidates pots. This means that the vast majority will remain with their workplace provider.

- **Motivations for exercising member choice are hard to predict** – it is by no means certain that consumers will act to increase their returns or reduce costs. Switching in non-workplace pensions and decisions to consolidate tend to be based on convenience and having savings in one place. This means that those who do engage with member choice may not benefit from lower costs and higher returns, and may end up with worse outcomes.
- **Those who engage are likely to be higher earners with bigger pots** – based on what we know about those who engage with DC pensions currently. This has implications for who the likely winners and losers of member choice are going to be, as smaller pots would lose the existing cross subsidy from larger pots, resulting in likely higher charges for those who remain in with their workplace provider.

In addition, costs could rise overall as a result of providers spending on marketing to entice those with bigger pots to join retail schemes. Evidence from Australia and retail providers in the UK shows these types of arrangements have a much higher marketing spend, as mass market consumer advertising costs significantly more than engaging with an employer client base.

Member choice reforms have an uncertain impact on productive finance

Increasing the availability of investment for productive finance assets is one of the key motivations for these reforms. However, there are a range of factors that will influence whether these reforms increase or decrease the availability of investment for unlisted equities and other private assets.

For example, while stapling could lead to reduced inflows and outflows of members and capital, member choice is likely to drive greater disruption, at least in the short term, as people use the option to be able to switch schemes or providers. This could reduce levels of capital to invest in unlisted equities, but this in turn will be dependent on rates of switching, and types of schemes that members are allowed to switch into. Furthermore, it will be important to understand whether demand side pressure from savers is likely to drive better returns, or switching is motivated by other factors such as convenience, as this in turn will drive investment choices.

If the Government moves ahead with delivering the reforms, decisions around the wider policy environment will be critical for influencing whether they increase or decrease available levels of capital for productive finance assets.

1. Introduction and context

This report explores the impact of the two proposed Government reforms to workplace pensions in the UK. These are:

- **Member choice** – allowing savers to choose which pension pot their employer puts contributions into.
- **Stapling** – whereby a saver's pension pot is with the pension provider of their first employer, unless they decide otherwise.

The following sections draw on new quantitative research with employers and modelling of the potential impact on savers to improve the evidence base around each of these reforms.

- **Chapter 2** of the report summarises the results of a poll of 1,002 employers, which provides new evidence on their perceptions of member choice and stapling reforms, employers' potential behavioural response, and potential costs around implementing these reforms.
- **Chapter 3** of the report sets out how a move to a retail pricing model – a likely consequence of member choice reforms – could impact different groups of savers.
- **Chapter 4** of the report considers the potential impact of member choice reforms on the productive finance agenda.
- **Chapter 5** summarises the results and conclusions of the research.

Background to the research

The UK faces a longstanding policy issue around deferred small pension pots. The combination of automatic enrolment into workplace pensions with a highly mobile labour market means that this issue is likely to get worse, with a million new deferred small pots worth under £1,000 appearing each year.[i] This has potential consequences for savers in the form of lower investment returns, higher charges, and lost pension pots.

The proposed reforms around member choice and stapling are a response to this policy problem, seeking to deliver a 'pot for life' for more savers by stopping the creation of a new pension pot by default when someone switches jobs. As well as potentially driving better outcomes for savers, the Government also intends that consolidation of pots will direct more savings towards productive finance assets by improving economies of scale around how pensions are invested. Finally, there is the intention for member choice to engage more people in pension saving earlier on in their savings journey, and therefore improve decision-making on pensions throughout someone's life, including at retirement.[ii]

Part of the aim of this research is to determine if these reforms are likely to meet government objectives. In addition to this, it is also important to understand the impact of these reforms on the wider objectives of pensions policy, including any potential unintended consequences which could be detrimental to certain groups of savers. The below framework sets out how member choice reforms could impact different stakeholders in pensions.

Table 1: Member choice impact framework

Member choice	Employers	Additional administration resource and cost
		Reduced incentive to engage in pensions decision-making as a means of recruitment and retention
	Savers	Greater need to engage in pensions decision-making
		Reduced cross-subsidy to smaller pots
		Improved choice of pension options or schemes
	Providers	Incentive to target marketing and product development to those with bigger pots
		Reduced administrative costs from managing small pots
		Transitional upheaval from shifting market dynamics

Source: WPI Economics analysis

Working with the ABI and its members, we set out a series of key questions, the answers to which could help us understand the likely impact of these reforms. Some of the questions addressed in this research include:

- How are employees likely to respond to the freedom to choose and / or change their workplace pension provider? What are the likely consequences of a decision to switch?
- Is consumer engagement likely to be sufficient to drive an effective and efficient market?
- Are 'switchers' likely to be evenly spread across demographics? Are they likely to be concentrated among those with higher incomes and larger pots (and likely better knowledge and financial literacy)? If so, what would the likely impact be on the market and individual savers? Could this create detriment?
- Are provider and market responses to these reforms likely to support overall policy aims of reducing under-saving among target groups?
- Are stapling and member choice likely to increase or decrease employer pensions administration costs?
- How will employers respond to these reforms? What is the likely impact on savers?
- How will these reforms affect the productive finance agenda?

The next section analyses the role of employers in the workplace pensions system at present, and considers the impact of 'pot for life' reforms on their role and approach in the future.

2. Impact of the reforms on employers

Employers play an important role in workplace Defined Contribution (DC) pension saving. At present, they choose the provider or scheme for their staff, helping to ensure that savers have a product that meets their needs. They also play a major administrative role in enrolling employees, making contributions, and other tasks. Finally, they are a major contributor to their employees' total pension savings by paying employer contributions.

This role could change significantly because of the proposed reforms, potentially breaking the link between an employer and the workplace pension of their current staff. As a result, understanding the employer perspective on these reforms is critical.

In summary, our survey found:

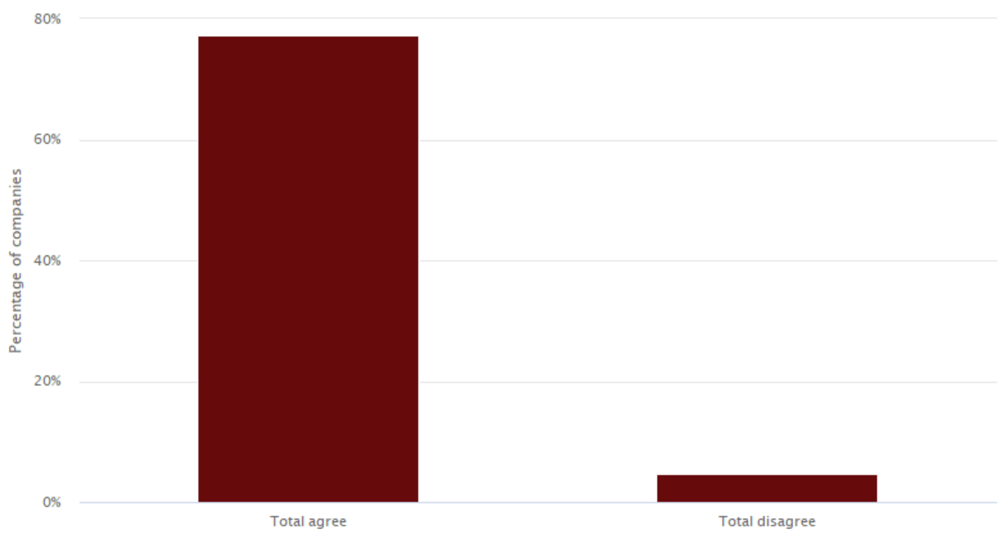
- Employers see themselves as playing an important role in delivering good pension outcomes for employees.
- Employers are worried about the potential for reforms to damage employees' pension outcomes.
- Employers feel their relationship with pensions will change as a result of the reforms.
- Reforms are likely to increase costs of pensions administration to employers.

Below, we explore these findings in more detail:

Employers see themselves as playing an important role in delivering good pension outcomes for employees

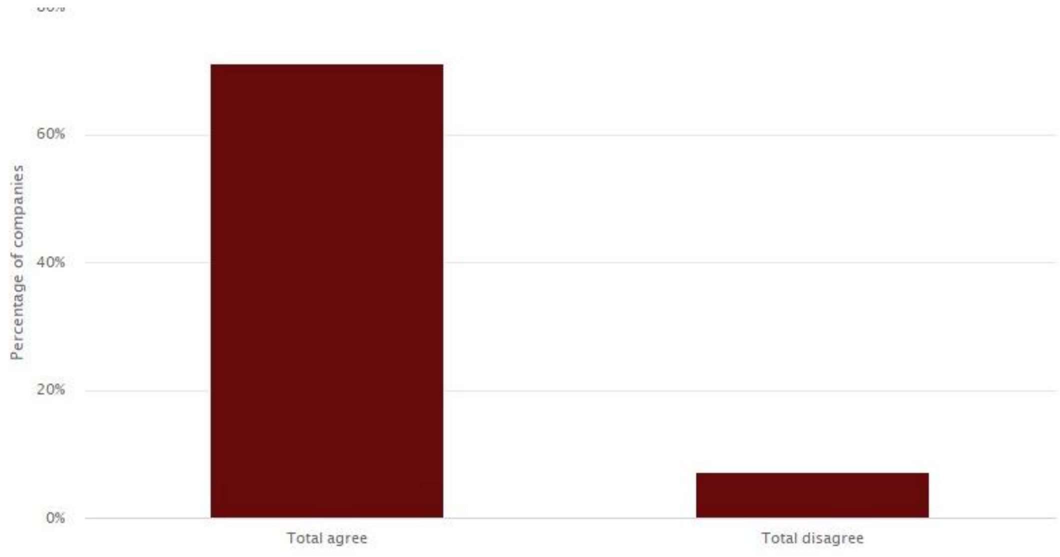
Many employers recognise that the choice of their current workplace pension scheme is an important decision that has significant implications for their employees, and put significant time and resources into getting this right. When asked about their choice of workplace pension, a large majority of employers believe that choosing the right workplace pension provider is important for ensuring that their employees receive the right pension (79%). Over three-quarters of employers were also confident that their current scheme is managing their employees' pensions effectively (77%) Figure 1. In addition, 71% indicated that they spent a long time considering their workplace pension.

Figure 1: I am confident that our current workplace pensions provider is managing our employees' pensions effectively.



Source: Censuswide and WPI Economics

Figure 2: I spent a long time considering the workplace pensions provider that we currently have.



Source: Censuswide and WPI Economics

When asked further about key aspects of their current workplace pension scheme Figure 3, the most common response from employers was highlighting the value for their members / employees (32%), closely followed by the value for money that the pension provider / scheme provides for the employer themselves (31%). Practical considerations were also highlighted, with 30% of employers identifying the ease of implementing the scheme as important. A similar proportion also identified the costs to employees and themselves as key aspects of their current workplace pension. This suggests that employers prioritise employees' needs when it comes to workplace pensions, while also wanting to manage their own costs and admin burden.

However, there are some differences between the priorities of small and large businesses. Among businesses with less than 10 employees, the ease of implementing and managing the workplace pension scheme was highlighted as a key aspect by 35% of businesses, whereas far fewer businesses identified providing value for their employees (21%) or allowing employees the choice to make environmentally or socially responsible investments (17%) as important. By contrast, among large businesses with 250+ employees, the three aspects of their workplace pension schemes most selected as being key were: providing value for money for the employer (35%), allowing employees the choice to make ethical investments (32%), and providing value to their employees (32%).

Figure 3: Now thinking about the specific features of your current workplace pension, what, if anything, would you say are the key aspects?

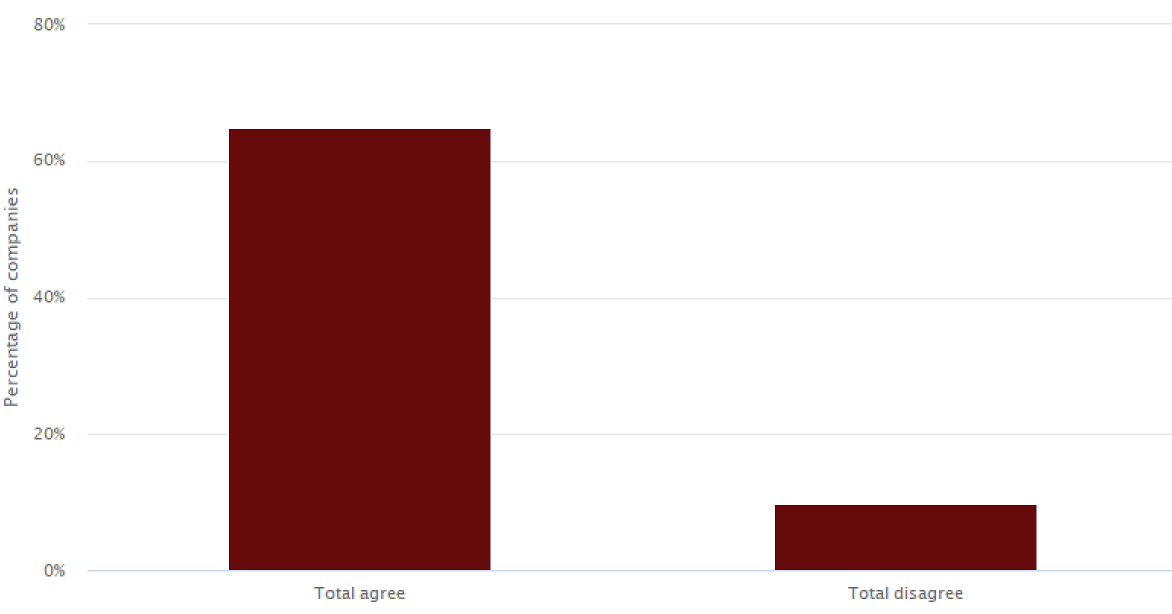
Source: Censuswide and WPI Economics

Employers are worried about the potential for reforms to damage employees' pension outcomes

The polling presented employers with details around the proposed reforms on stapling and member choice, before asking a series of questions about how they would respond to these.

Employers expect that the increase in the number of pension schemes they would have to manage will make it more difficult to assure value for employees. 65% of employers responded that they would find it difficult to assess the quality of the different pensions schemes the company would now be contributing to Figure 4. This suggests that the reforms could be detrimental to the important role that employers play today in supporting better pension outcomes for their staff. A higher proportion of large businesses (250+ employees) than small businesses (<50 employees) responded that they would find it difficult to assess the quality of the different pension schemes – 71% vs. 62% – perhaps reflecting the potential for there to be many more pension schemes to consider when a business has more employees.

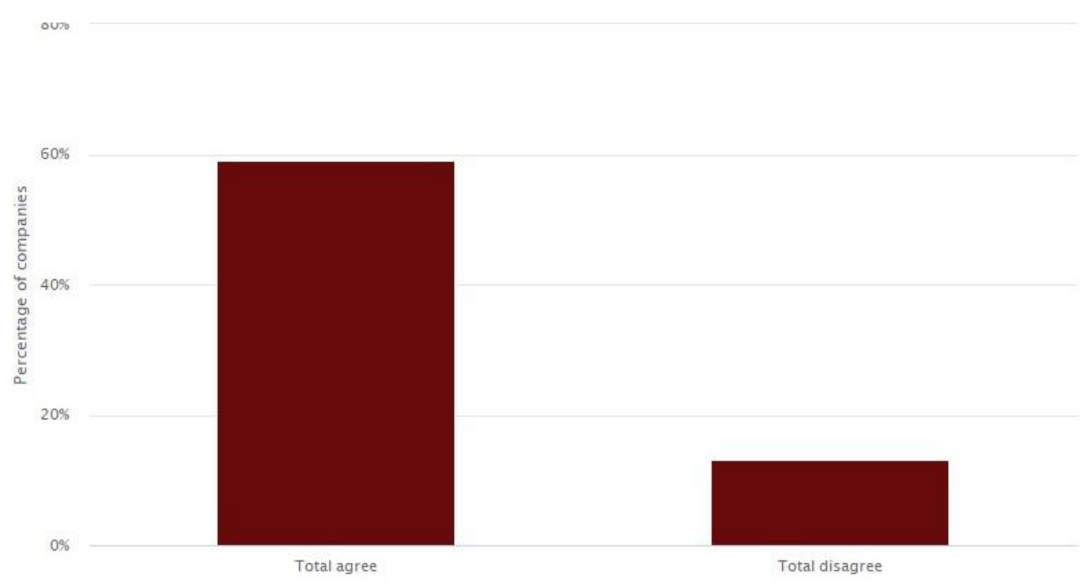
Figure 4: I would find it difficult to assess the quality of all the different workplace pensions the company would now be contributing to



Source: Censuswide and WPI Economics

In addition to feeling they can't assess the quality of their employees' pensions because of the reforms, employers were also concerned about employees making decisions about their workplace pensions alone. Overall, 59% agreed that they would worry that employees would make bad pensions decisions if they had to choose for themselves, with 13% disagreeing.

Figure 5: I would worry that employees would make bad decisions about their pensions provider if they had to choose themselves.

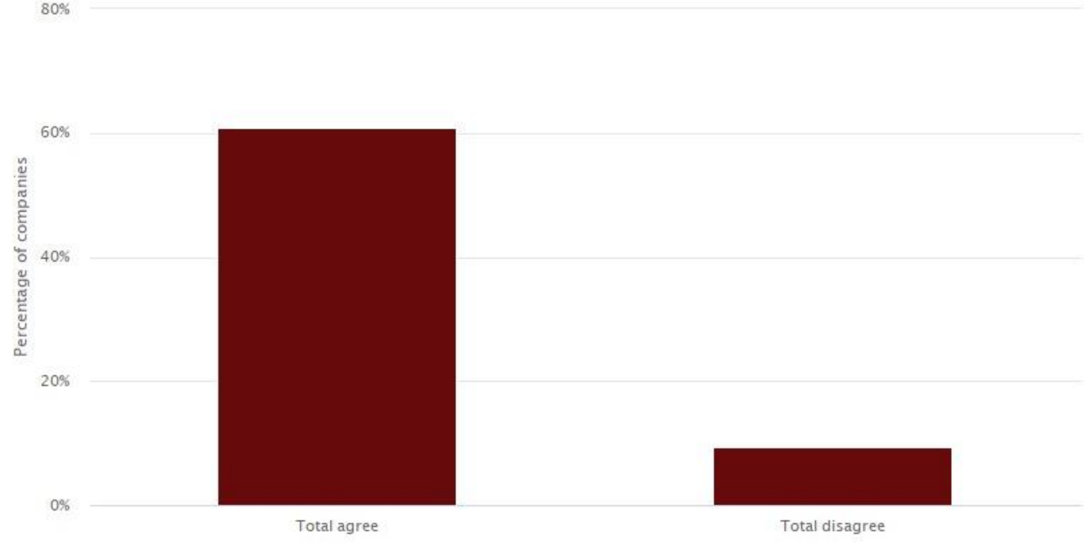


Source: Censuswide and WPI Economics

On the positive side, employers recognised the potential of the reforms to give employees the freedom to choose a pension that works for them – although this appears to be a more common view amongst employers with 250+ employees (64%) than employers with less than 50 employees (57%). This suggests a degree of nuance in how employers see these reforms – it gives staff more freedom to

make a choice about pension saving, but there is concern about the basis on which decisions may be made, and that the supporting role of the employer is more limited.

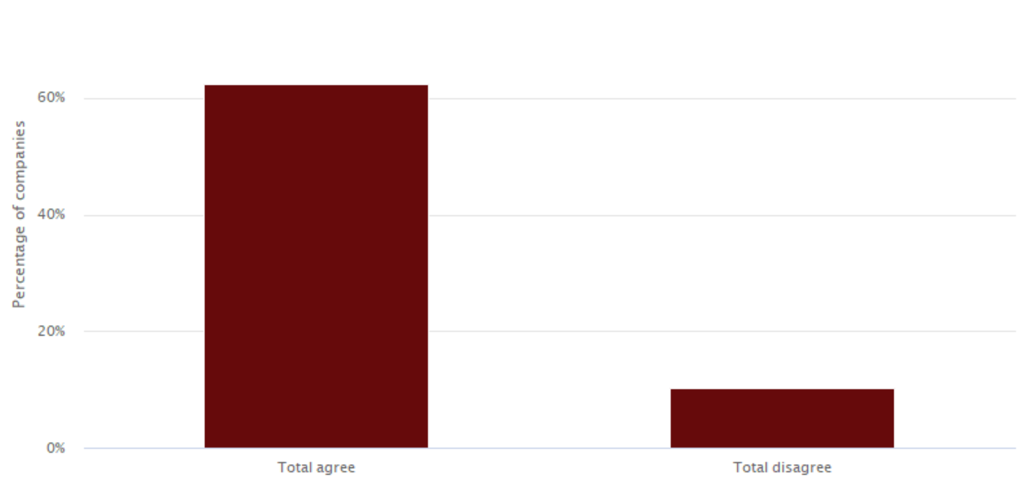
Figure 6: This would be positive for staff by allowing them the freedom to choose a pension that works for them



Source: Censuswide and WPI Economics

Ultimately, 62% of employers agreed that they are worried that the reforms would lead to their employees getting worse pension outcomes compared to just 10% who do not worry that there would be a negative impact for employees Figure 7.

Figure 7: I worry that this situation would lead to our employees getting worse pensions outcomes.



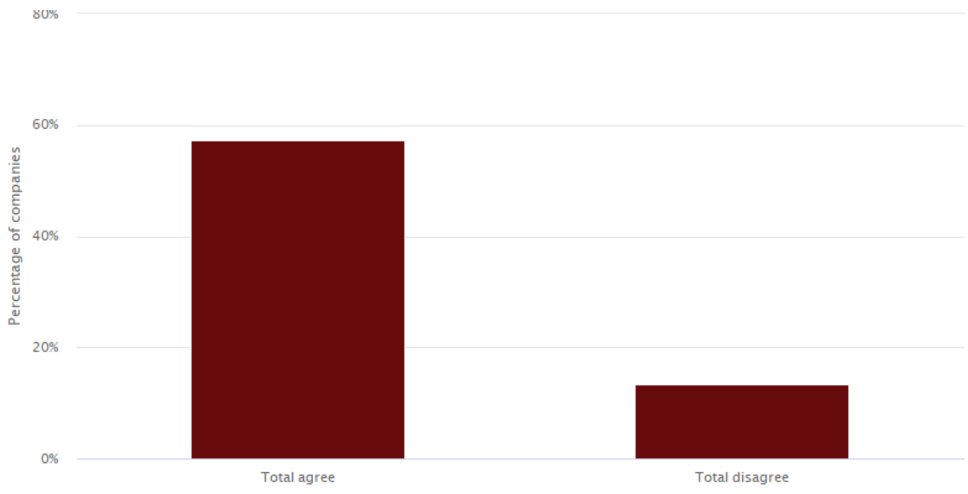
Source: Censuswide and WPI Economics

Employers feel their relationship with pensions will change as a result of the reforms

57% of employers said that their interest in the quality of the workplace pension scheme that they choose for employees would be reduced as a result of the reforms Figure 8, although this is slightly more true of employers with 250+ employees (62%) than employers with less than 50 employees

(52%). This suggests that the demand-side pressure that comes from employers in the pensions market would be more limited under member choice and stapling. As we will go on to say, this has significant implications for how the market could operate in the future.

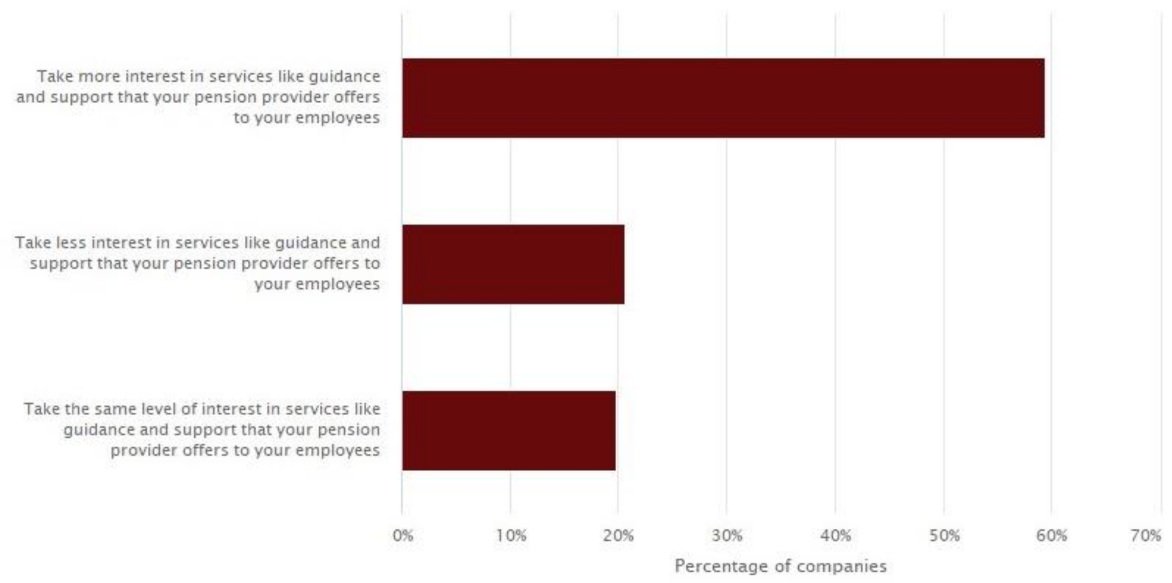
Figure 8: This would reduce our interest in the quality of the workplace pension we choose for the staff that remain.



Source: Censuswide and WPI Economics

Positively, employers did report that they would be more interested in advice and guidance services for their staff in the event of stapling and member choice reforms being introduced. This may be motivated by a perceived need to support employees to navigate choices under the new system, or a desire to provide tools and resources which would encourage employees to remain with the current scheme or provider chosen by the employer.

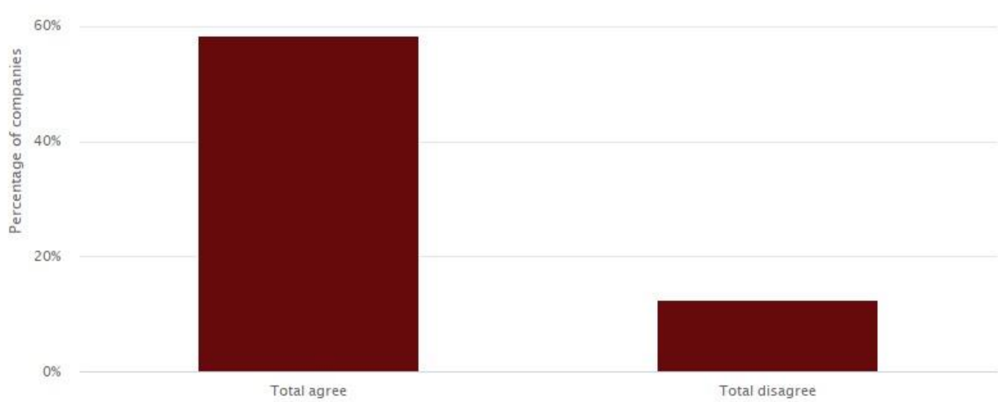
Figure 9: Under these proposals, employers would still need to automatically enroll employees, where they don't already have a pension or where they don't choose their own pension. In response to this change, how is your business interest likely to change?



Source: Censuswide and WPI Economics

However, firms also think that the reforms would lead to a challenge for their recruitment and retention activities, with 58% of all respondents saying that the reforms would negatively impact on their ability to include pensions as a positive part of their overall benefits package. This was particularly true of larger firms, where 68% of respondents in businesses with between 250 and 500 employees said that they believed this. This may indicate that larger firms would pivot towards other types of employee benefits as a result of member choice.

Figure 10: This would negatively impact on our ability to include our pensions offering as a positive part of our overall benefits package.



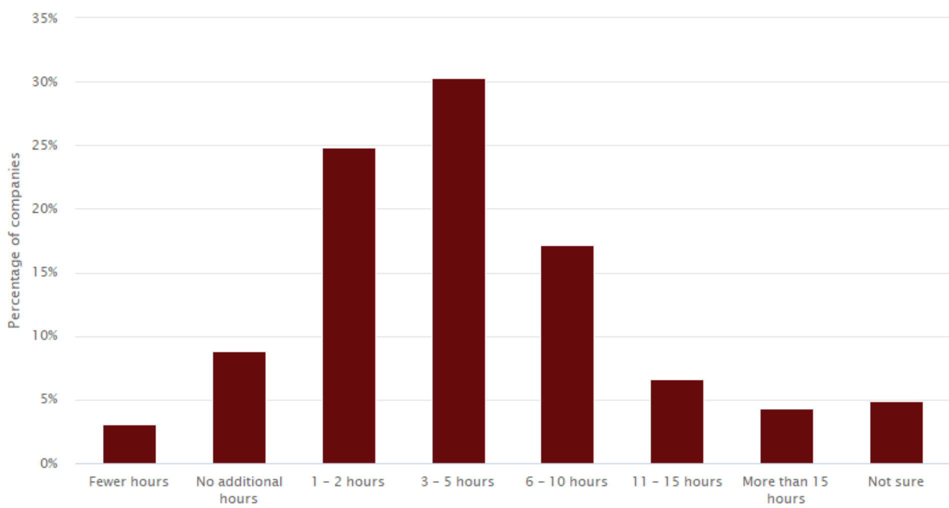
Source: Censuswide and WPI Economics

Reforms are likely to increase costs of pensions administration to employers

The proposed reforms will also have an impact on the level of resources employers must dedicate to managing workplace pension schemes. 63% of employers are worried that the proposed reforms will increase their payroll provider costs, and 28% of employers said that they estimate having to increase their staff time dedicated to activities related to workplace pensions by more than 5 hours per month Figure 11.

Modelling based on the findings of this polling suggests that if member choice and stapling are introduced, an additional 16,000 FTE employees will be needed by employers across the whole economy. Based on these individuals being paid a median salary, this is equivalent to an additional salary expenditure on activities related to workplace pensions of £550 million per year.

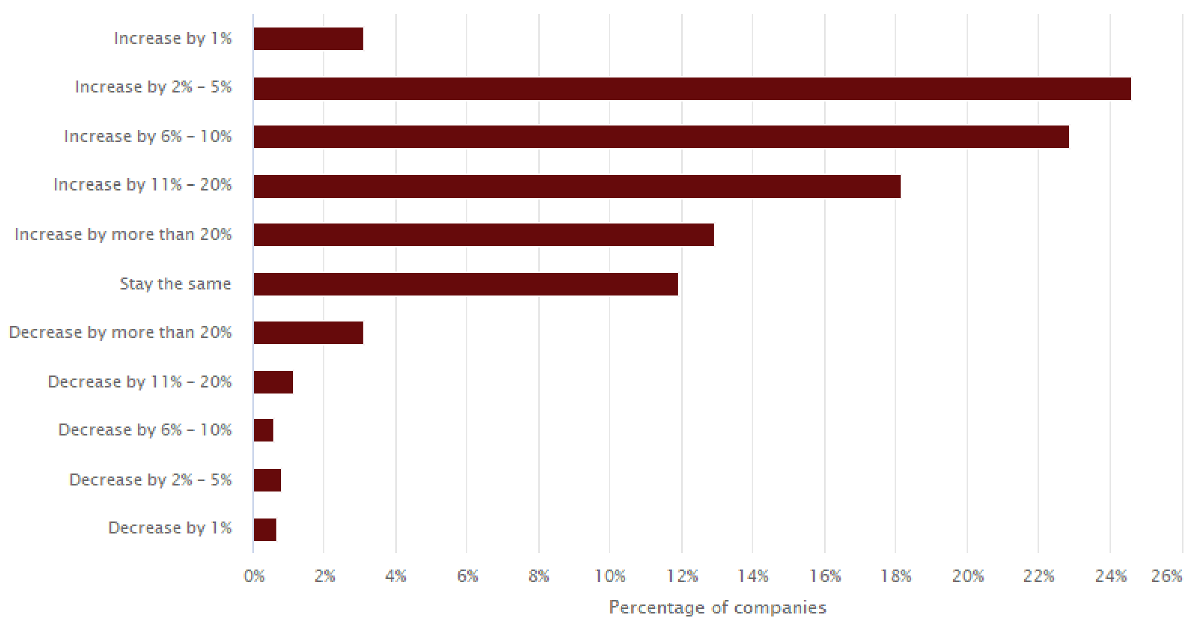
Figure 11: How many extra hours of staff time per month, if any, do you estimate would be spent on activities related to your workplace pension, as a result of this requirement?



Source: Censuswide and WPI Economics

Among employers who outsource some or all of their workplace pension activities Figure 12, 82% predicted that the proposed reforms would lead to an increase in the monthly costs of their pension-related activity, with a majority (54%) predicting an increase in spending of more than 5%.

Figure 12: You said that you outsource either some or all of the activities related to your workplace pension (e.g. to a payroll provider), what do you think would happen to your monthly costs in this scenario?



Source: Censuswide and WPI Economics

Summary

The perspective of employers is vital for informing any decision around policy design and implementation for member choice or stapling. The survey findings demonstrate that employers play an important role in securing good quality pensions for their staff in the current market, and ensuring that employees' current pensions work well for them.

Overall, the results suggest that proposed reforms around member choice and stapling put this at risk, with the potential that employers will be less interested in the quality of pension for staff that remain, and would find it difficult to consider the value for money of many different providers and schemes. Furthermore, the reforms present an increased admin burden for firms that could cost £550 million across the economy.

3. How member choice could change the pensions market

As set out in the previous section, demand-side pressure in the workplace pensions market currently comes from employers, who select a pensions scheme or provider. Under a member choice model, this demand side pressure logically shifts towards the individual who can opt out of an employer's solution to choose their own pension provider. The implications of this change for savers and the wider market are explored in detail in this chapter.

This section covers three key areas.

- How will savers respond to member choice? How many people are likely to switch, who are they, and on what basis will they make their decision?
- Will the market response to consumer decisions support policy goals around helping lower income savers?
- What is the potential size of these impacts at the level of individual savers?

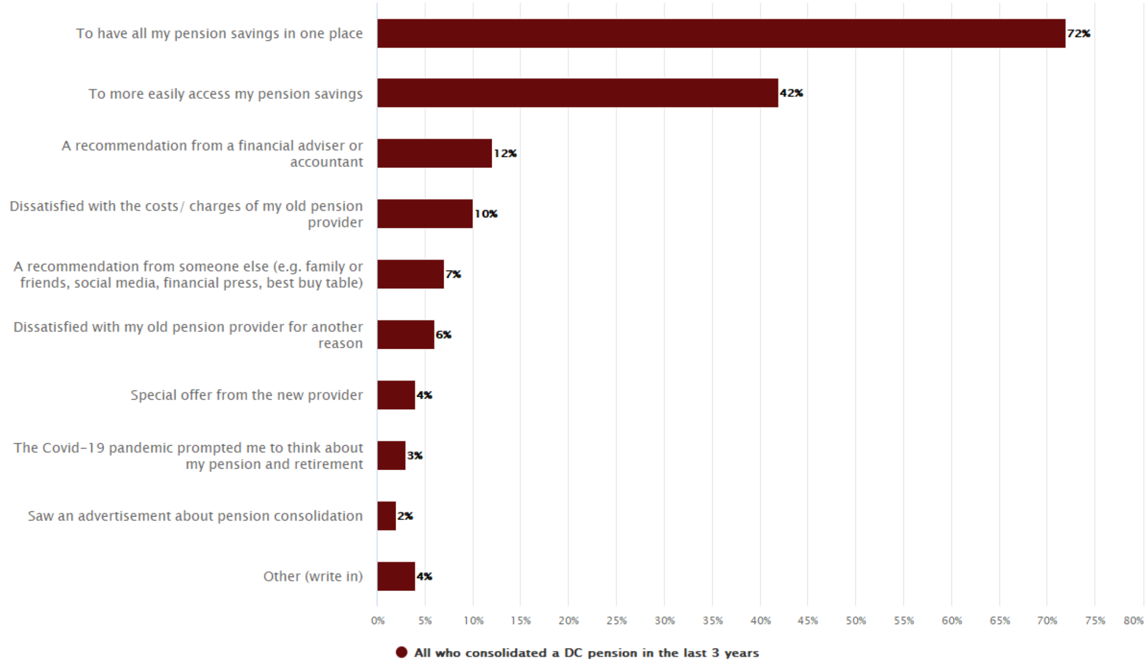
How will savers respond to member choice?

Most evidence points to the likelihood of a small minority of savers engaging with member choice. As the success of automatic enrolment demonstrates, defaults are a powerful force on human behaviour, with opt-outs remaining low even in difficult economic times.[iii] Evidence from choice of default investment funds in Sweden confirms this, with switching rates for pensions dropping significantly once a major Government funded advertising campaign had dissipated.[iv]

Of those who do engage, there is evidence that those exercising choice may not seek lower charges and higher returns. Studies have shown that individual capitalisation schemes are characterised by inelasticity of demand, meaning that savers barely respond to changes in fees and returns. This may be due to short-term planning horizons resulting in disengagement with the long-term idea of future retirement. Another reason may be that pensions decisions are complex and understanding them may come at a high cost for the consumer.[v]

Recent findings from the People's Pension confirm this, showing that savers rarely consolidate pots to achieve lower fees or better returns. Overwhelmingly, the reasons for consolidating revolve around convenience: making it easier to track finances and moving assets into a pot with better service.[vi] This is confirmed by FCA Financial Lives Survey data considering the motivations of the small number of savers (5% in the last year) who consolidate their pensions, with lower charges a motivation in only 10% of cases.[vii]

Figure 13: Why did you consolidate your defined contrition pension?

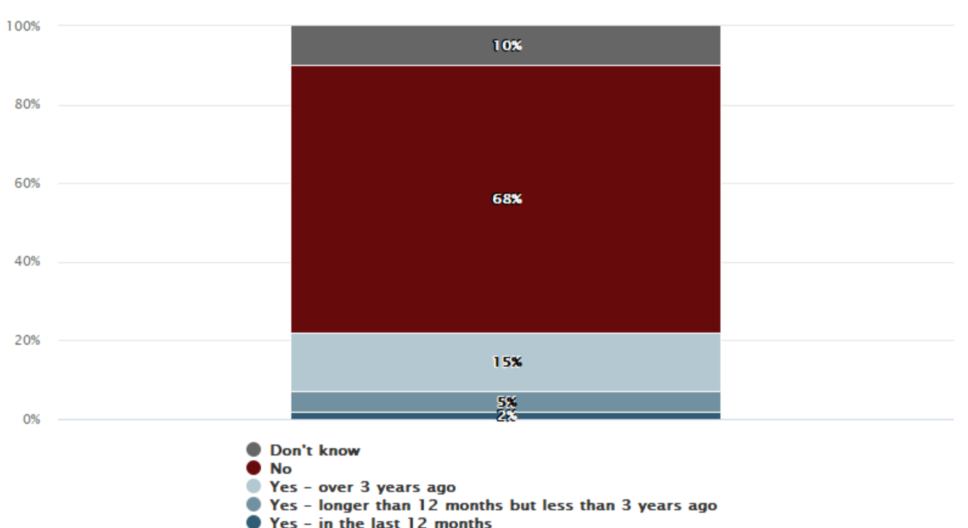


Source: FCA Financial Lives Survey 2022[viii]

It is worth noting in future that Pensions dashboards could deliver many of the benefits of the consolidation market, without savers needing to transfer providers, potentially to a product with higher fees.

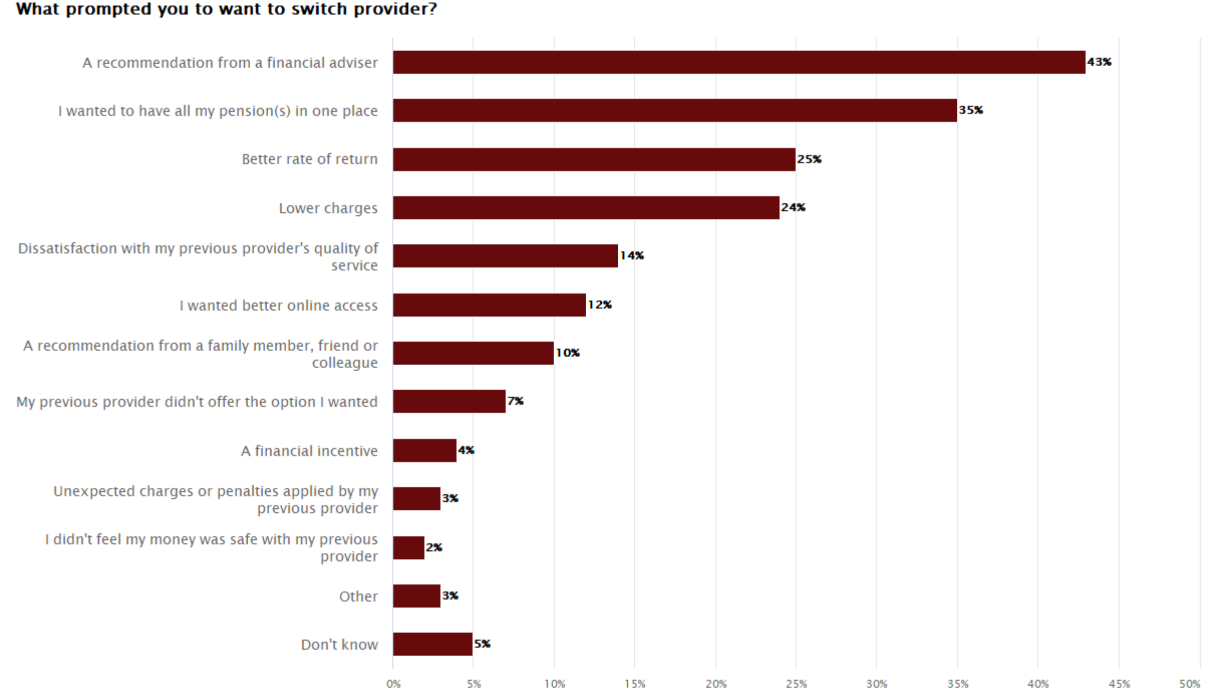
Evidence from the non-workplace DC pensions also suggests that it is a minority of savers who exercise choice by switching providers, with the remaining participants being largely uninterested in switching. Unlike in the case of consolidation, costs and returns are significant factors (for 24% and 25% of switchers respectively), although not to the same extent as wanting to have pensions in one place, or a Financial Adviser recommendation.

Figure 14: Proportion on non-workplace DC pension holders who have switched provider (2022)



Source: Financial Lives 2022

Figure 15: What prompted you to want to switch provider?



Source: Financial Lives 2022

Considering evidence from DC pensions more broadly, we can see that consumers who are highly engaged in managing their DC pensions tend to be older; male; higher educated; and have higher incomes and pot sizes. This gives us some indication of the group who are likely to engage under member choice.

Table 2: Percentage of different groups of adults who are currently contributing to a DC pension who are highly engaged

Sex	Male	32%
	Female	17%
Age	18-24	8%
	25-34	17%
	35-44	23%
	45-54	35%
	55+	34%
Education	Higher education	32%
	Other education	17%
Personal income	Less than £15k	9%
	£15k - <£30k	11%

	£30k - <£50k	28%
	£50k+	50%
DC pension pot size	<£5k	7%
	£5k to <£20k	20%
	£20k to <£75k	40%
	£75k to <£150k	55%
	£150k to <£250k	73%
	£250k+	79%

Source: Financial Lives 2022[ix]

In both the case of the non-workplace DC market and the consolidation market, financial advice is a major influence on whether someone exercises choice. As a result, it is reasonable to assume that having access to a financial adviser during your working/saving life might be a key determinant of who would exercise member choice in workplace pensions. Previous polling for Aviva suggests that only one in ten of people on middle incomes access advice about their pension during their working life.[x]

What does this tell us about the likely saver response to member choice?

Member choice in workplace pensions is a unique proposition, with dynamics that are not fully replicated in any other market. Therefore, arriving at exact estimates of the scale of switching is not straightforward. However, we have brought together some strands of analysis which might give us some sense of the likely effects, including the proportion of people who exercise choice:

- **The non-workplace DC pensions market** – according to Financial Lives Survey (2022), 7% of individuals in non-workplace DC pensions market switched products in the last 3 years in 2022. This is a useful proxy, but it is worth noting that these are not default products, and so people are likely be more engaged than those in the workplace market. In addition, they are more likely to have received advice which is also likely to lead to higher switching.
- **Consolidation** – according to Financial Lives Survey (2022), 5% of those with a DC pension consolidated their pension in the past year. Again, this will include some non-workplace savers who are not currently defaulted, and most of them are consolidating into their current workplace pension.
- **Advice** - as we have set out, accessing advice is a key driver of switching or consolidating behaviour, and pensions engagement generally, and could help to drive suitable switching decisions. FCA surveys suggest 8% of adults accessed financial advice in the year up to 2022, with many of them at or approaching the decumulation phase.[xi]
- **Labour market** – Under member choice, it is likely that switching jobs would be a meaningful trigger to switch to a pension other than that of your new workplace pension provider, i.e., to keep your previous one, switch to a new one, or move to a different solution entirely. Analysis of Annual Population Survey data for this report found that there are about 4.2 million job switchers a year, and that they tend to be younger and lower earning workers, who are less likely to be engaged in DC pensions.[xii]

Drawing on this evidence, we estimate **between 5% and 8% of savers** could exercise member choice in the initial years of the reforms.

There is mixed evidence as to people's motivations for exercising choice, but some likely factors include: convenience or the need to consolidate, seeking better costs and returns, and recommendations from an adviser. Those who exercise choice are likely to be older workers with higher incomes and access to financial advice.

How does the market respond to new consumer dynamics

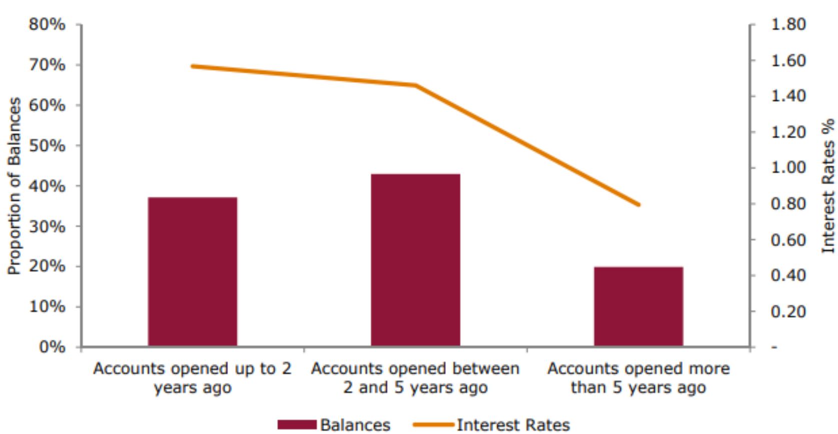
It is widely acknowledged, including by Government, that currently there is a cross-subsidy in the current pensions market which benefits those with smaller pots, who also tend to be younger and on lower incomes.[xiii] Analysis by the Pensions Policy Institute (PPI) found that, assuming an Annual Management Charge (AMC) of 0.5%, the average break-even point for a deferred small pot for a Master Trust is £4,000, necessitating a degree of cross subsidy in the market.[xiv]

Based on our discussions with ABI members, one potential impact on market dynamics of implementing member choice could be a move towards a retail or individualised pricing model, and the removal of the cross-subsidy in the market currently. This theoretically would follow from how choice and demand-side pressure in the market change under member choice. With all savers able to leave their workplace scheme, providers will be incentivised to attract the most profitable savers into their scheme or product by offering better returns for savers with bigger pots who are more likely to switch. In practice this would mean different fees for different types of savers, and an increase in the use of fixed fees to cover admin costs, which would result in a better deal for savers with bigger pots. This next section explores the potential impact of this, based on the evidence on how choice might be exercised that was set out in the previous section.

If member choice leads to retail pricing in workplace pensions, this could result in a model characterised by lower costs and better returns to more engaged consumers, and a reduced cross-subsidy to less engaged consumers. A relevant example here is the ISA market, where returns on investment for less engaged consumers are lower than returns for engaged consumers. In Cash ISA markets, less engaged consumers had half the interest rates of more engaged consumers according to a market study in 2015.[1][xv]

Figure 16: Differential interest rates and balances on Cash ISAs offered by brands with a large share the Personal Current Account (PCA) market

[1] Unlike a bank setting a cash interest rate, no pension provider would choose poor investment performance, although they may have less incentive to chase better returns for less engaged consumers. In addition, the dynamics of the ISA market took place under a pre-consumer duty environment.



Source: FCA Cash Savings Market study[xvi]

It is worth considering the impact of these dynamics playing out under member choice in pensions. The reforms could cause existing inequalities in pensions to deepen further – as the richest consumers could potentially secure better deals, and those with lower savings stay with lower performing defaults while being hit with increased charges and a loss of cross-subsidies from larger pots.

However, this outcome is predicated on savers responding rationally to the new rules and switching providers on the basis of lower costs and higher returns, and this behaviour in turn driving the supply side of the market. This is by no means certain, given evidence from the consolidation market in the UK, as well as international evidence showing that other motivations are often more important to consumers.

Evidence from Mexico shows that the introduction of member choice did not translate into consumer benefits, in spite of achieving a high rate of switching (18%). In total, 40% of consumers switched to schemes which had both lower returns and higher fees. For 53% of switchers, their decision resulted in lower savings at retirement; for 17.6% of switchers, their eventual savings were worth 20-100% less.[xvii] As a result, there is potential for member choice to result in poor outcomes for savers across the board, rather than benefits to a minority of engaged switchers. Of course, previous research into this space have found that the demand-side pressure from employers in the market is by no means perfect, leading to the introduction of the charge cap for default funds.

With member choice, costs for all consumers might go up as providers increase their marketing costs following a move to individual pricing. Evidence from Australia shows total annual spend on marketing in a sample of four super schemes varies between 3% and as much as 12% of admin fees. Australian consumers face charges ranging from 0.67% to around 1.2% for a balanced fund,[xviii] while the same figure for members of UK workplace scheme is just 0.48%, on average. A move to retail pricing might increase the marketing spend (especially given there is evidence advertising entices consumers to switch[xix]), which would likely translate into higher fees for scheme members.

A critical consideration for these scenarios is which types of providers are allowed to compete in the workplace DC pensions market under member choice. One potential scenario is that non workplace providers become part of a member choice market, while a series of bigger providers continue in the

workplace space. This divergence could create complications for the set of winners and losers under member choice.

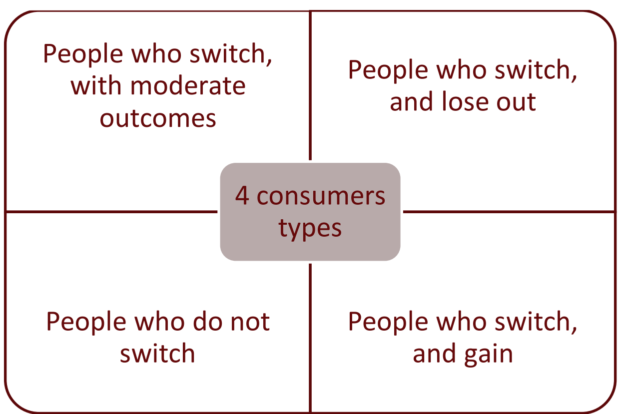
The section below sets out an indication of what these impacts could look like at the level of an individual saver.

Modelling the impact

To explore how retail pricing might impact on the value of individual pension pots, we created a pension savings model. The model allows us to vary inputs such as charges, investment returns, wages and contributions to explore how the changing pensions landscape will impact on the amount of money savers have when they enter retirement. The model is built around inflation and wage forecasts from OBR,[xx] and assumes the current minimum default contribution rates of 8% throughout the individual's career.

To illustrate how a move to member choice might affect individual pots, let us consider the four potential consumer outcomes of this change:

Figure 17: Four consumer types



PEOPLE WHO SWITCH, WITH MODERATE OUTCOMES

Those are people who engage in member choice, but with neutral outcomes compared to the status quo. They are likely to still pay slightly higher fees due to higher charges in a new product.

PEOPLE WHO SWITCH, AND LOSE OUT

Those are people who exercise their choice, but with poor results. They switch to pensions that have lower returns or higher charges, and end up with a smaller pot at retirement.

PEOPLE WHO DO NOT SWITCH

Those are people who carry on as before, and do not engage with their pension.

PEOPLE WHO SWITCH, AND GAIN

Those are the people who engage in member choice, and make the most of it – they secure the best deals for themselves, and end up with a larger pot at retirement. Ideally, we would like this to be the most populous group.

WHAT CAN WE EXPECT BASED ON EVIDENCE?

1. **Member choice will lead to pension providers increasing the marketing spend, which may be passed onto consumers in the form of increased consumer charges. They may also lose the cross subsidy from bigger pots.**

If increased costs of marketing translate into increased fees, all consumers might lose out as they pay increased charges. The current average annual DC pension charge is 0.48%, which is significantly below the cap of 0.75%.[xxi] We suggest that that over time, member choice could push average charges higher, due to increased marketing costs as well as the loss of cross subsidy from the bigger pots that have left workplace schemes.

2. **Even with better marketing, some consumers may fail to engage – and without a continuous advertising campaign, it is likely many people won't engage.**

We estimate **between 5% and 8% of savers** exercising choice in the initial years of the reforms, based on the analysis in the previous section of the non-workplace, consolidation, and advice markets. As a result, the default action is likely to be no engagement in member choice.

3. **Even those who engage may not see any increase in their pot size at retirement.**

Currently, consumer decisions to switch are not based on pricing, or at least not predominantly. Evidence shows that, when switching, consumers value convenience most significantly. In the non-workplace DC pensions market, only about a quarter of savers switch because they chase increasing returns – the overwhelming majority decides to change provider to simplify their finances, or because they believe the new provider has more convenient tools or better service. Pensions are highly complicated: 'virtually nobody' has the time, energy and knowledge needed to make the right choice.[xxii]

For those reasons, it is likely that many people will choose to switch to pots that offer more convenience, but not significantly different, returns on investment. In Mexico, for 53% of switchers, their decision resulted in lower savings at retirement; for 17.6% of switchers, their eventual savings were worth 20-100% less.[xxiii]

4. **A significant minority of consumers might switch to pots with less value.**

Risk of scams, missing out appropriate governance, choosing unsuitable investment strategies are all serious risks if we move all execution risk onto consumers who, so far, have been disengaged from their pension pots. The majority of the population have difficulty interpreting financial information and making financial decisions.[xxiv] Worryingly, international evidence from Mexico shows that, following introduction of member choice, 40% of consumers switched to schemes which had both lower returns and higher fees.[xxv]

5. **The most financially savvy consumers will secure the best deals – but with consequences for those left behind**

Consumers who are highly engaged in managing their DC pensions tend to be older; male; higher educated; and have higher incomes and pot sizes. If we assume those consumers remain more engaged as we move to member choice, and exercise their choice based on costs and returns, existing inequalities could deepen further.

Table 3: What could this mean for different consumer groups? [xxvi] [xxvii]

	PEOPLE WHO SWITCH, WITH MODERATE OUTCOMES	PEOPLE WHO SWITCH AND LOSE OUT	PEOPLE WHO DO NOT SWITCH	PEOPLE WHO SWITCH, AND GAIN
How big is this group likely to be?	1.5 - 3%	1.5 - 3%	92 - 95%	1.5 - 3%
Who is more likely to be in this group?	Those who are engaged, but less financially savvy.	Those who are engaged, but less financially savvy.	Mostly those who are younger, on lower incomes, women, and people from ethnic minority backgrounds.	Mostly those who are older, higher earners with higher pots.
What might a move to member choice mean for the deals consumers get?	We assume similar returns to the status quo (nominal return of 6% p.a.), but higher charges (an increase from 0.48% to the current cap of 0.75%).	We assume lower returns (5.5% p.a. as opposed to 6% p.a.), and higher charges (an increase from 0.48% to the current cap of 0.75%).	We assume similar returns to the status quo (nominal return of 6% p.a.), but higher charges (an increase from 0.48% to 0.65%).	We assume higher returns (6.5% p.a. vs 6% p.a. nominal return), and lower charges (0.35%).
Pension pot change at retirement for median earner	- £14,000	- £37,000	- £9,000	+ £37,000

In practice, this is a simplification of the full range of impacts. For example, some people who do not switch will not lose out, as workplace providers who gain market share could benefit from scale which would mitigate the effects of high-value savers switching into retail products. In addition, there could be a move to much granular pricing based on pot size for those that remain in their workplace pension. Furthermore, the interaction of member choice reforms and stapling is not fully captured by these scenarios.

Conclusions

The evidence shows that a move to retail pricing will not uniformly benefit all consumers. Depending on saver behaviour, pricing that benefits only a minority of consumers, and/or higher costs overall, are potential outcomes to these reforms. In any scenario, it is questionable whether the needs of lower income savers with smaller pots would be supported by the reforms, a group that automatic enrolment policy was created to support.

4. Impact on investment

One of the core Government aims of this policy is to increase the availability of pension savings for investment in productive finance. As it states in the call for evidence:

> *There is further evidence that the current set up of the AE system creates inflows and outflows of members and capital that require admin management with impacts on rebalancing, revenue streams and liquidity needs. Therefore, the creation of one pot invested for life could offer the opportunity for more enduring savings horizons that could then support diversity of asset allocation including Private Equity and other productive finance assets. This could in turn potentially deliver higher returns for individuals.*[xxviii]

More widely, the UK Government has made increasing asset allocation to productive finance a key policy objective, including through the Mansion House Compact, the impact of which is being monitored by the ABI, in which providers target 5% asset allocation to unlisted equities by 2030.

The full impact of these reforms on the productive finance agenda is by no means certain. There are a range of factors that will influence whether these reforms increase or decrease the availability of investment for unlisted equities and other private assets, which are summarised below:

- **Member choice or stapling -** this is an area where it is critical to distinguish between member choice and stapling as specific interventions. While stapling could lead to reduced inflows and outflows of members and capital by stopping a new pot being created when someone switches jobs, member choice is likely to drive greater disruption, at least in the short term, as people use the option to be able to switch schemes or providers. This may require providers to have more liquidity to guard against the impact of switching, reducing levels of investment available for productive finance.
- **The scale of switching** – based on evidence from UK pensions and advice markets, we have suggested that levels of switching out of current workplace pensions are unlikely to be high, with defaults acting as a significant influence on saving behaviour. If switching remains low, then this may limit the negative effect that member choice would have on the liquidity that providers and schemes would need.
- **The providers who participate in a member choice market –** there is a significant policy decision around which types of providers are allowed to compete in a member choice workplace market. If it is a small number of bigger workplace providers, then the impact of choice on productive finance would be more limited, as all participants would have similar scale to invest in productive assets. If participants are allowed to switch to non-workplace products, such as SIPPS, then this could mean savings into products with less ability to invest at scale, as well as greater fragmentation across the market.
- **Demand side pressure on returns in a retail market –** savers in SIPPs have a great deal of freedom as to where they invest their savings, and so there is a degree of uncertainty as to whether they are likely to invest in private assets after they switch. Data suggests that a minority of switchers in the non-workplace market are motivated by a desire to increase their returns (25%), with few to none reporting this motivation in the consolidation market. This suggests a level of uncertainty as

to whether savers exercising member choice are likely to pursue greater returns by investing in unlisted equities.

- Policy decisions about value for money – across all types of pension provision, there is increasing drive for schemes and providers to pursue real returns for savers as part of the Value for Money Framework and other initiatives. The extent to which these schemes are successful in shifting market norms and driving consolidation will have an impact on the overall level of investment in productive assets. In addition, there will be policy decisions about whether to extend the framework to cover the non-workplace DC pensions market in the event of member choice being introduced.

As a result of this set of unknowns, we have been unable to arrive at a clear quantification of the likely impact of these reforms on productive finance investment. If the Government moves ahead with delivering the reforms, decisions around the wider policy environment will be critical for influencing whether they increase or decrease available levels of capital for productive finance assets.

5. Summary and conclusion

Member choice and stapling are complex reforms which will impact workplace pensions market dynamics in a variety of ways. They are intended to improve the system by eliminating the proliferation of deferred small pots, boosting saver engagement, and supporting investment in productive finance. Our analysis shows they may have limited benefit in supporting the latter two objectives. In addition, they may create unintended consequences in terms of increasing charges for lower- and middle-income savers, risk disengaging employers from workplace pensions, and could result in a large increase in the employer pensions administration burden.

As a result, care is required in deciding whether to implement member choice and stapling and, critically, the set of wider policy and regulatory decisions around their implementation, as well as how they interact with other initiatives such as the Value for Money Framework. We encourage Government to build on the findings of this research by further exploring the potential consequences of these reforms before any decision to proceed with implementation.

Annex: Polling and methodology

Modelling

We created a pensions savings tool which allows us to investigate the effect that pension reform might have on individual pots. We can compare the final savings when we vary:

- The investment return;
- Costs;
- Proportion of earnings saved;
- The starting value of the pot;
- Length of time until retirement.

The tool will allow us to undertake scenario-based analysis to understand how member choice might affect savings of certain types of individuals.

The baseline assumptions in the tool can be found below:

Pension pot comparison model

Author: Julia Wyjadlowska (WPI Economics)

How to use:

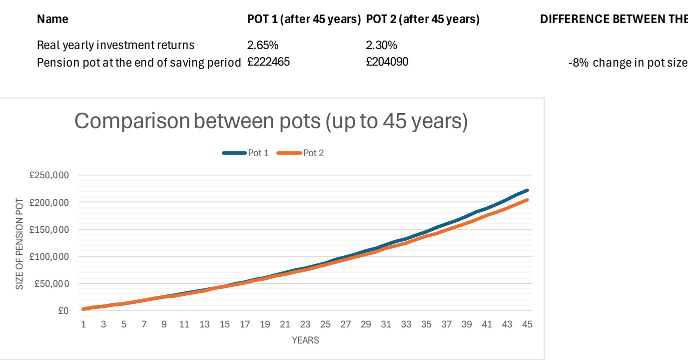
- Specify your inputs in the inputs box on the left hand side
- The two comparison pots can vary by any number of model inputs
- The outputs on the right will update automatically
- The chart shows comparison up to 50 years - the 50-year time period here doesn't update automatically, but it can be manually changed if needed

Inputs

Name	POT 1	POT 2
Inflation rate	3.00%	3.00%
Nominal wage growth	3.50%	3.50%
Nominal investment return	6.00%	6.00%
Charges (%)	0.35%	0.70%
Number of years (max: 100)	45	45
Yearly contributions	8%	8%
Starting wage	£30,000	£30,000
Starting pot value	£0	£0

Outputs

Name	POT 1 (after 45 years)	POT 2 (after 45 years)	DIFFERENCE BETWEEN THE POTS
Real yearly investment returns	2.65%	2.30%	
Pension pot at the end of saving period	£222465	£204090	-8% change in pot size



Polling

We conducted a 1,000 sample survey with Censuswide of respondents who have responsibility for decisions about DC pensions at their company. The demographic split captured can be found below. Soft quotas were in place to capture a mix of sectors.

- Size by employees (2-9, 10-49, 50-249, 250+)
- Sector (SIC section)
- Business age
- Business location

We opted not to report a number of the results from the polling in the full draft, an explanation for two of these results can be found below. The full tables are available from Censuswide.

One of the questions in the polling asked if employers "already allow employees to choose which pension provider their employer contributions are paid to?" to which 45% answered yes. Having reflected on the wording of the question, we have low confidence as to whether this really indicates that nearly half of businesses already offer full member choice as envisioned in the proposed reforms. For example, these firms could offer member choice to certain senior staff, or on a one-off basis to someone requesting contributions be paid into an SIPP, rather than offering full member choice at the start of employment to all staff. As a result, we have not included this result in the main report.

Another polling question asked if businesses would increase or decrease employer pension contributions in response to member choice and stapling being implemented. The mean answer given was a 1.37% increase. We have carried out an analysis of the raw data, and found that suggesting an increase in contributions correlated strongly with reporting a higher than average expected increase in outsourcing costs, which is a highly counterintuitive result. Reflecting on the sequencing (the question immediately followed one about higher outsourcing costs) and wording, we expect that many respondents may have mistaken the question for another question about increasing costs associated with the reforms. As a result, we have very low confidence in this result, and have not included the result in the main report.

Both of these question merit further research and analysis in future work.

ENDNOTES

[i] https://www.gov.uk/government/consultations/ending-the-proliferation-of-deferred-small-pension-pots/ending-the-proliferation-of-deferred-small-pots
[ii] https://www.gov.uk/government/consultations/ending-the-proliferation-of-deferred-small-pension-pots/outcome/government-response-to-ending-the-proliferation-of-deferred-small-pots
[iii] https://www.gov.uk/government/statistics/ten-years-of-automatic-enrolment-in-workplace-pensions/ten-years-of-automatic-enrolment-in-workplace-pensions-statistics-and-analysis
[iv] https://www.chicagobooth.edu/review/when-nudging-forever-case-sweden
[v] https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Consumer-Confusion-The-Choice-of-AFORE-22105
[vi] https://peoplespartnership.co.uk/wp-content/uploads/2024/02/Pension-transfers-understanding-member-behaviour-report.pdf
[vii] https://www.fca.org.uk/financial-lives/financial-lives-2022-survey
[viii] https://www.fca.org.uk/financial-lives/financial-lives-2022-survey
[ix] https://www.fca.org.uk/financial-lives/financial-lives-2022-survey
[x] https://wpieconomics.com/publications/planning-for-retirement-in-the-2050s-a-new-report-with-aviva/
[xi] https://www.fca.org.uk/publication/financial-lives/fls-2022-consumer-investments-financial-advice.pdf
[xii] WPI Economics analysis of Annual population survey October 2022 to September 2023.
[xiii] https://www.gov.uk/government/consultations/addressing-the-challenge-of-deferred-small-pots/addressing-the-challenge-of-deferred-small-pots-a-call-for-evidence
[xiv] https://www.pensionspolicyinstitute.org.uk/media/pqynaq5p/20200723-deferred-members-final-report-for-the-website.pdf
[xv] https://www.fca.org.uk/publications/market-studies/cash-savings-market-study
[xvi] https://www.fca.org.uk/publication/market-studies/cash-savings-market-study-final-findings.pdf
[xvii] https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Consumer-Confusion-The-Choice-of-AFORE-22105
[xviii] https://www.pensionspolicyinstitute.org.uk/research-library/research-reports/2024/2024-02-27-how-could-a-lifetime-provider-model-impact-members-employers-and-industry/
[xix] https://www.chicagobooth.edu/review/when-nudging-forever-case-sweden
[xx] https://www.pensionspolicyinstitute.org.uk/media/xfybvxtq/20230926-the-dc-future-book-9-2023.pdf

[xxi] https://www.gov.uk/government/publications/pension-charges-survey-2020-charges-in-defined-contribution-pension-schemes/pension-charges-survey-2020-charges-in-defined-contribution-pension-schemes

[xxii] https://www.lse.ac.uk/research/research-for-the-world/impact/solving-the-pension-problem-steering-change-in-sweden

[xxiii] https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Consumer-Confusion-The-Choice-of-AFORE-22105

[xxiv] https://committees.parliament.uk/writtenevidence/81933/pdf/

[xxv] https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Consumer-Confusion-The-Choice-of-AFORE-22105

[xxvi] https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Consumer-Confusion-The-Choice-of-AFORE-22105

[xxvii] https://www.pensionspolicyinstitute.org.uk/media/f4fln41r/20240215-what-could-effective-pensions-engagement-look-like.pdf

[xxviii] https://www.gov.uk/government/consultations/ending-the-proliferation-of-deferred-small-pension-pots/outcome/government-response-to-ending-the-proliferation-of-deferred-small-pots