Lifetime Provider Team
Department for Work and Pensions

Your ref	
Our ref	CY/JMR
Date	24 January 2024

via email : caxtonhouse.lifetimeprovidercallforevidence@dwp.gov.uk

Dear Lifetime Provider Team

USS response: Call for Evidence: Looking to the future: greater member security and rebalancing risk

I am writing in response to your consultation outcome document *Ending the proliferation of deferred small pots* and Call for Evidence: *Looking to the future: greater member security and rebalancing risk.*

We would highlight two key areas of our response:

- Deferred small pots. Without an exclusion for 'true' hybrid schemes (i.e. those where an individual member accrues both DB and DC benefits) there remains a significant likelihood of detriment to members; and
- Lifetime Provider model. This would be a fundamental change to the UK pensions system. Alongside a range of other issues, without careful thought about the carve outs for those employers offering high quality pension provision (including hybrid schemes), existing schemes like USS would be unlikely to continue.

About USS

Universities Superannuation Scheme (USS) was established in 1974 as the principal pension scheme for universities and higher education institutions in the UK. We work with around 330 employers to help build a secure financial future for 528,000 members and their families. USS is a hybrid pension scheme, which means we have both a defined benefit (DB) part – the Retirement Income Builder – and a defined contribution (DC) part – the Investment Builder.

We are one of the largest pension schemes in the UK, with total assets of around £75.5bn (£73.1bn DB / £2.4bn DC at 31 March 2023).

Ending the proliferation of deferred small pots

We welcome your response to the consultation on small pots, and proposals for a multiple default consolidator framework. It is encouraging that there seems to be broad consensus on the way forward to arrest the proliferation of very small pots in the mass occupational DC market, and that attention can be turned to the significant challenges of implementation.

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We also welcome your acknowledgement of the specific issues as they relate to hybrid schemes like USS, where members can build a mix of DB and DC benefits. Our members are not immune from the small pots issue, but in all cases their DC benefits typically attached to a DB benefit. The consolidation of a small DC pot held by our members would not necessarily simplify their pensions situation, nor deliver significant savings, indeed it would likely increase complexity and increase costs to the sector[1]. It would also increase costs to us as we would still need to administer their DB benefits. Furthermore, the nature of our hybrid scheme means that members often cease and restart making DC contributions, based on changes in their salary and in the scheme's salary threshold (the threshold above which DC benefits are accrued).

Given our limited exposure to small pots as defined, we are unlikely to take part in the industry delivery group, but we will look to engage with you as you develop the detailed policy to ensure our members are appropriately treated. This should be as simple as excluding members' DC pots that are in hybrid schemes from the eligibility criteria.

Looking to the future: Great member security and rebalancing risk

We also welcome the call for evidence on future changes to the UK pension system, considering the lifetime provider model and role of CDC. These are important policy debates – automatic enrolment has been a huge success, but it is right to be ambitious and to look to address some of the major challenges the pensions system faces, particularly around decumulation.

Lifetime Provider model

This would be a very radical change to the UK pensions system. At present employers – either voluntarily or as required by law – fulfil a key role in pension provision. Moving from an occupational pensions system to a primarily retail retirement savings one should not be viewed as simply an emerging facet of the small pots debate; this would be such a fundamental change that significant thought, analysis and modelling should be required before any changes are further considered (akin to the work undertaken to inform policy making and decisions around the introduction of auto-enrolment). This would inherently need to be a debate around what outcomes the UK pension system is intended to deliver. In this response we refer to some key considerations for our members and employers, as well as wider considerations for the pensions market as a whole.

Clearly there are a wide variety of employer perspectives across the UK economy on pensions. Some see a pension as a key part of their value proposition to employees, while others may have little interest and satisfy regulatory minimums. The current policy framework manages these two extremes by ensuring all employers have access to an authorised and regulated scheme (contract or trust based) to enrol employees into but allowing employers to arrange their own (often more generous) schemes should they wish. For the higher education sector, that has resulted in USS operating on a sectoral basis, with employer contributions higher than statutory minimums, and a hybrid mixture of DB and DC benefits

Our employer covenant has been a key determinant of the outcome of our scheme valuations, both for assessing the funding level of the scheme and the cost of future benefits. As part of the 2020 valuation process, our employers made additional commitments beyond those normally required of DB sponsors to stand behind the scheme. A key element underpinning the funding and structure of the scheme is exclusivity, which has been a requirement since its inception. The covenant support measures materially strengthened our covenant, mitigating our deficit and reducing the cost of future benefits. USS remained a hybrid scheme with a significant DB element able to invest in growth assets as an open scheme with a long time horizon.

[1] Members in our DC section currently pay ***no charges on their savings (excluding transfers in)***; transferring their DC savings to a small pot consolidator would inherently materially increase the cost to members.

A move to a model where employees had a right (or indeed just an expectation) that they could redirect their contributions (potentially including the full employer contribution) to a retirement savings arrangement of their choice would inherently therefore partly unwind the covenant support measures. If, as indicated by PLSA, up to a third of eligible members might choose to do so[2] (and at present we have no view on our own eligible members), this would raise serious implications as to whether schemes which share risks between members and need a critical mass of employees could continue. Open DB/hybrid schemes like USS therefore face a potential risk from even extended Government discussion of Lifetime Provider models (with a thirty year covenant horizon there is a presumption of some regulatory certainty and stability).

Noting our particular position, we offer some brief thoughts on the key considerations, many of which are raised in the document itself on page 44, that should be explored further before deciding to implement the lifetime provider reforms. These are set out below:

Employers

- We've not at this stage sought the views of our participating employers on these proposals – we would though highlight a number of potential issues. Given our concerns above, we particularly welcome the suggestion of employers offering high quality pension arrangements being outside the scope of these proposals. In what circumstances would employers be exempt from either a) a requirement to allow workers to select their provider, or b) a requirement to enrol a worker into their lifetime provider? It would seem clear that exemptions would be needed to allow forms of collective provision – as we note above, DB/hybrid schemes like USS and employer-led CDC schemes would be extremely destabilised if most new employees were enrolled into a previous DC scheme rather than the collective scheme provided by the employer.
- There are then further potential issues around whether employers would still be required to offer any occupational pension arrangement, the existing work that employers do to educate, inform and engage with their employees on pension issues (and which we look to support for our members) and potential administrative costs. Again, we undertake ongoing work to support employers with submitting contributions and the like.

Providers

- There is a key question whether and which providers would be allowed (or even forced?) to accept contributions from other workers and employers. We imagine that employer sponsors of DB schemes, and potentially CDC schemes, would not welcome building up benefits and risk for workers they no longer have a connection to. We note that in Australia this is a possibility, but we do not know how many, if any, DB schemes have chosen to open up in this way.
- Quality and suitability are important, but in the Master Trust market (and the workplace contract-based market), the UK already has in place some key controls and requirements that are in many ways stronger than the Australian market, including default fund requirements, cost caps and a robust authorisation regime. There could need to be some strengthening of these requirements to provide individuals with a suitable range of investment and decumulation options, the latter of which is subject to ongoing policy development.
- The implications for the provider market could be profound. In a lifetime provider world, there would be major changes in distribution models, marketing needs and commercial imperatives. Acquiring members at the start of their working careers will be much more important, as will competing for members to switch (transferring their pension and ongoing contributions). This could have very significant impacts on the market which would need to be carefully considered.

[2] TWO-THIRDS OF EMPLOYEES DO NOT WANT TO CHOOSE THEIR OWN WORKPLACE PENSION PROVIDER | PLSA

- These changes to market dynamics could stymie attempts to increase investments in more illiquid assets. Stability in cash flows is key to providers feeling able to allocate capital to less liquid assets, and it is unclear that the lifetime provider model would increase stability versus the employer-led model we have today. There would therefore appear to be a significant contradiction between the ambitions outlined in the Mansion House speech and these proposals.
- Whether non-workplace pensions should be able to become lifetime providers. We note that the Call for Evidence talks explicitly about workplace pensions, but it is unclear why, in a world of member choice, personal pensions that meet the same standards as workplace schemes would not be included.

Individuals

- On flexibility, there are two key considerations: whether members could elect to switch provider at the point of taking a new job (as they can in Australia), but also if they can switch at any point and require their employer to divert contributions to their new scheme. If members are completely free to switch, this could change the distribution model for pensions, with greater emphasis on retail sales and fierce competition for profitable members.
- Currently workplace providers offer different terms to different employers. They also cannot refuse particular groups of employees, even though they may know they are likely to be unprofitable. Would it be a requirement for a lifetime provider to offer the same terms to all members, and to accept all prospective members? How would risks of adverse selection be managed?
- Value for money (VfM) – there are risks that a consumer led market (assuming that this is a feature of the model) for pensions will not maximise VfM. Members may not understand the impact of fees and may choose more expensive options. Consideration would need to be given to how these risks could be mitigated, and whether they are outweighed by the benefits of fewer pots.

We expect that some respondents will have more evidence and views to offer on these points and look forward to seeing the outcome of the Call for Evidence.

Providing security in later life for members, boosting returns, and managing risk (CDC expansion)

After ensuring individuals are saving enough to support their later life, helping members use their DC savings when they reach later life is perhaps the most important policy question facing pensions in the UK. Pooling longevity and investment risk, in the way that CDC is designed to, could be valuable to members who want a stable lifetime income.

In terms of timing, there could be advantages to prioritising the growth of CDC (if it was concluded that this should be the default DC option) over implementing a lifetime provider model, as the starting point for the lifetime provider model is critical. Members are unlikely to switch to CDC from their default lifetime provider option.

However, whilst USS is an authorised master trust, the majority of our members' benefits are DB (see the asset split in 'About USS'). We look to support our members with DC savings to decide how to use them in combination with their DB pension and provide suitable options, but we see limited demand now or in the future from our members for a CDC vehicle or other innovative decumulation options.

Furthermore, our stakeholders currently provide DB provision (within a hybrid framework), and we would expect there would be an exemption from any requirement to offer CDC benefits, even with respect to the DC benefits we provide. Our core DB benefits both pool risk and provide a pension income for members.

We look forward to the discussion that this Call for Evidence will bring about and are happy to discuss any of these points in more detail with your officials. As noted above, these proposals do present risks to our members which we are keen to ensure are mitigated.

Yours sincerely

Carol Young
Group Chief Executive Officer