DWP Department for Work and Pensions

Likely industry responses to the workplace pension reforms: Qualitative research with pension providers and intermediaries

By Andrew Wood, Peggy Young, Dominika Wintersgill and Naomi Crowther, RS Consulting Ltd

This report provides the findings of a study conducted by RS Consulting on behalf of the Department for Work and Pensions (DWP) designed to investigate and understand the pensions industry's responses to the workplace pension reforms that were introduced as part of the Pensions Act 2008.

This research focused on the details of the reforms as proposed by the independent Making Automatic Enrolment Work Review[1], published by the government in October 2010. The review supported the details of the reforms as outlined in the Pensions Act 2008 and proposed specific changes that will be taken forward as part of the Pensions Bill 2011.

Methodology

The study was qualitative in nature, and consisted of in-depth, face-to-face interviews with 35 participants, including:

- 20 workplace pension providers. All of the major UK workplace pension providers participated in this study, covering the vast majority of the market.
- 15 intermediaries that advise employers on workplace pension products. A range of sizes of organisation participated.

Research findings

The workplace pensions industry in 2011

The pension providers in the study could be grouped into two broad categories:

- High-end providers: these targeted larger employers or those with medium to high average salary levels. They were often reluctant to take on commission-based business, focusing instead on employers that were willing to pay intermediaries a fee for advice.
- Mass market providers: these catered for a wider range of employers in terms of size and salary, potentially including smaller and lower salaried employers that arranged their pension through a commission-based intermediary.

Intermediaries could also be grouped according to their size and function:

- Large intermediaries were typically Employee Benefits Consultants (EBCs) that provided advice to employers in a range of areas including pensions, investment strategies and wider employee benefits. They typically worked exclusively on a fee-basis, rather than charging commission on products sold.
- Medium-sized intermediaries typically employed between 20 and 100 consultants. They tended to cater for small and medium enterprises (SMEs) of up to around 100 employees with higher than average salaries. Traditionally medium-sized intermediaries had operated through a mix of fee-based and commission-based business, although by 2011 most were planning to move to an entirely fee-based model.

Background to the pension reforms

Overall, most providers and intermediaries agreed that the reforms were being introduced into a market that had changed significantly in recent years. It was seen as having evolved from one that was very profitable, with high and complex

[1] Johnson, P., Yeandle, D., Boulding, A. (2010), *Making automatic enrolment work – A review for the Department for Work and Pensions.*

charging structures, to one with lower margins, greater competition, and increased pressure for each provider and intermediary to occupy a profitable space in the market.

Many providers and intermediaries pointed out that it was impossible to isolate the industry's responses to the reforms without also taking into account factors such as the competitive environment, the recession and the Retail Distribution Review (RDR).

The stakeholder one per cent charging cap that was introduced as far back as 2001 was widely believed to have changed the face of the workplace pension market. While it improved value for members, it also reduced profitability for providers as well as the scope for them to pay commission to intermediaries. There was effectively a 'ceiling' of one per cent above which providers could not charge. As a result:

- Higher-end providers became less willing to pay up-front commission to intermediaries, preferring to focus on employers who were prepared to pay a fee for their advice, allowing them to charge a lower and more competitive AMC to members.
- Mass market providers had always been more reliant on commission-based business: only those providers with a very low cost-base, usually larger providers, chose to remain in this part of the market. Others had left the market or consolidated.

The impact of the RDR

In June 2006, the Financial Services Authority (FSA) launched the RDR. From the end of 2012 adviser firms will no longer be able to receive commission set by product providers in return for recommending their products.

Where commission-based business already existed, some providers and intermediaries predicted that there might be a rush to sell new commission-based business until the RDR is implemented in December 2012, essentially because both providers and intermediaries felt that, as long as the commission-based model is an option, lower-paid and smaller employers would continue to prefer that approach, assuming they would not be prepared to pay for advice.

Post-RDR, relationships between providers, intermediaries and employers were expected to evolve significantly. Few expected employers that previously paid commission to be willing to pay a fee for advice, and most were unsure whether FSA-permitted alternatives to commission, such as consultancy charging, would be accepted in the market. Consequently, in mass market schemes, many providers expected to sell schemes directly to employers with no intermediary involvement.

Provider and intermediary responses to the workplace pension reforms

While most providers agreed that automatic enrolment would lead to increased membership within existing schemes, some pointed out that many of the newly-enrolled savers would be the lowest paid on average, and so might be unprofitable. The increase in providers' administration and communication costs relating to the reforms and automatic enrolment were expected to exacerbate this.

Intermediaries and providers typically said that their strategies would hinge upon remaining profitable in the post-reform, post-RDR market. As a result both providers and intermediaries were considering the adjustment of existing products as well as creating new products that would be tailored toward the post-reform market. Part of the future success of their organisations was expected to depend on whether they would be able to sell benefits packages and other products that employers and employees valued: in other words, to add value, beyond that offered by a basic pension scheme with no bundled advice.

Providers and intermediaries commonly planned to offer new or existing services online, as this was seen to offer greater flexibility to employers and employees as well as encouraging greater engagement from employees. Flexible benefits platforms, for example, were often offered by intermediaries at present, and many were planning to increase the functionality of these further in the future, not only by allowing access to a wider range of benefits, but also by improving their functionality in terms of communication.

Many providers were planning to introduce a wider range of workplace savings vehicles over the coming years. A common way that they planned to do this was through the introduction of corporate wraps, or integrated financial planning platforms for employees. While some high-end providers already offered such products in 2011, they were commonly mentioned as an example of a product that could 'add value' after the introduction of the reforms.

Some providers and intermediaries were considering products that offered employers a set of compliance tools that would automatically ensure that the employer was complying with all of the requirements of the pension reforms, without the need for external involvement or advice.

Occasionally providers were also considering offering more 'basic' solutions as an alternative to National Employment Savings Trust (NEST), in particular in terms of access and investment options. They expected to pare down existing products in order to be able to offer these at a charge that was comparable to NEST. However, their products were still expected to hold some advantages over NEST, such as greater fund choice or more flexibility on payments.

Advice and guidance about the reforms given to employers

Many intermediaries expected more work helping employers to implement the reforms over the next few years. Intermediaries were typically already using the workplace pension reforms as a discussion point in their current marketing materials and in meetings with current and potential clients. They typically planned to further increase such communications as the reforms approached.

Intermediaries suggested that the date an employer was likely to begin planning for the pension reforms was dependent on their size. The largest employers, some facing automatic enrolment within two years, were the group most likely to be asking about the reforms currently. Conversations with intermediaries often focused on communications, timings and costs, and well as key operational and administrative challenges, such as the process of automatically enrolling staff, deducting contributions and dealing with opt-outs.

Intermediaries stressed that the advice given to a particular employer would always be bespoke to their particular circumstances.

Sources of advice available to smaller employers

While large firms already had established channels of advice, many small employers had no experience of offering a pension, and some intermediaries and providers felt there was no obvious and well-known source of information about the reforms available to them.

Many predicted that when the time came for small employers to automatically enrol their workforce, they would seek information and advice from their company accountant. This assumption was typically based on the fact that the accountant was the main finance professional available to all small companies, who would already be aware of the intricacies of their specific business. However, both intermediaries and providers suggested that accountants would only be in a position to provide very general information about the reforms and their implications for companies.

Some suggested that more information and advice was needed from the government in response to this perceived information gap, including publicity campaigns and call centre helplines, to ensure that small employers have time to make plans for automatic enrolment and consider whether an alternative provider to NEST would be an appropriate option for them.

The impact of NEST

Providers and intermediaries typically predicted that NEST would have a significant impact on the pensions market. The anticipated size of the scheme in terms of the number of members and its funds under management, alongside the fact that the NEST Corporation was set up by a government Act, meant that some felt it could inevitably become a significant player and set standards in the market. Some predicted that NEST could be a positive influence on the industry, as the publicity surrounding it would create interest in pensions among employers and employees.

Providers rarely predicted that NEST would have a detrimental impact on their own business. Rather than seeing NEST as a direct competitor, they generally believed it targeted the lower end of the market in terms of salary, which was largely un-catered for by current providers.

Providers sometimes told us that they would consider working with NEST to provide a tiered solution to larger employers, whereby lower-paid employees would be enrolled into NEST, and higher-paid employees into the provider's product. Some intermediaries agreed with providers that they would consider NEST alongside a traditional pension provider, as part of such a tiered solution.

NEST was often seen as setting a standard against which other products would be compared in terms of communications, with some providers and intermediaries hoping to emulate NEST's use of plain English in their future communications. NEST was also expected to further push forward the adoption of web-based propositions, with online technology to be more widely utilised by providers and intermediaries in the future.

Many providers and intermediaries expected NEST to have a substantial impact on provider charges, setting the 'baseline' level of charge for the post-reform pensions market: wherever alternative products charged more than NEST, they would be forced to justify what additional value they can provide.

Reactions to the Making Automatic Enrolment Work Review

Providers and intermediaries were typically aware of the recommendations of the review, viewing them as a sensible and pragmatic solution to industry concerns. Providers felt that the government had largely heeded their suggestions and recommendations and acted upon the views of the industry.

With regard to specific recommendations:

- Most providers and intermediaries were in favour of the proposal to align the automatic enrolment threshold with the income tax personal allowance, and align the bottom of the earnings band for contributions with the National Insurance (NI) threshold. Most felt this reduced the possibility of an individual being automatically enrolled into a scheme on a very low income and paying extremely tiny levels of contribution. This was also expected to alleviate the administrative burden on a provider of overseeing a large number of very small pension pots.
- Most intermediaries and providers welcomed the introduction of a three-month waiting period for automatic enrolment, believing it would save on the cost of setting up and administering a pension scheme for short-term and casual staff as well as staff choosing to leave in the first three months.
- Most were in favour of the proposed revisions to the certification process, with some suggesting that the previous definition of 'total earnings' caused unnecessary complexities and could have encouraged employers to decide against paying bonuses or employee overtime.
- Some suggested that the government's commitment to review the regulatory differences between trust-based and contract-based schemes could be a positive move, as it would prevent employers from selecting a scheme as a result of the short service refund rules.

While providers and intermediaries typically welcomed the recommendations of the review, many pointed out that several aspects of the reforms were still not finalised, effectively preventing the industry and employers from planning with certainty. Providers and intermediaries often expressed in very strong terms the need for finality in the coming months, given the proximity of the reforms.

The full report of these research findings is published by the Department for Work and Pensions (ISBN 978 1 84712 988 8. Research Report 753. June 2011).

You can download the full report free from: http://research.dwp.gov.uk/asd/asd5/rrs-index.asp

Other report summaries in the research series are also available from the website above.

If you would like to subscribe to our email list to receive future summaries and alerts as reports are published please contact:
Kate Callow, Commercial Support and Knowledge Management Team, Upper Ground Floor, Steel City House, West Street, Sheffield S1 2GQ. Email: Kate.Callow1@dwp.gsi.gov.uk.