Cass Business School
CITY UNIVERSITY LONDON

Pensions Institute

CAVEAT VENDITOR

The brave new world of auto-enrolment should be governed by the principle of *seller* not buyer beware

A Pensions Institute report for policymakers, regulators, providers, consultants, advisors, employers, and trustees

Debbie Harrison
David Blake
Kevin Dowd

October 2012

Caveat Venditor:
The brave new world of auto-enrolment should be governed by the principle of *seller* not buyer beware

Published October 2012

The Pensions Institute
Cass Business School
106 Bunhill Row
London
EC1Y 8TZ

www.pensions-institute.org

ISSN: 1367-580X

Contents

About the authors 3
List of abbreviations 3
Sponsor Statement 4
Foreword 6
Findings 9
Recomemendations 11

Section 1: How the DC scheme market works: A qualitative evaluation of the behavioural traits of sellers and buyers

1.1 What is auto-enrolment? 13
1.2 Who is the customer? 14
1.3 The supply and distribution chain 15
1.4 Charges 17
1.5 Design complexity 21
1.6 Regulatory bipolarity and opacity 22
1.7 Caveat emptor or caveat venditor? 24

Section 2:
Quantitative modelling of the default funds' investment strategies and charges

2.1 Assumptions made 26
2.2 The default fund spectrum 27
2.3 Charges 28
2.4 Asset allocation and the de-risking glide path 28
2.5 Key findings from the quantitative modelling 29

Section 3: The kite mark for auto-enrolment

3.1 The rationale for a kite mark 31
3.2 Who will organise the kite mark? 31
3.3 Role of the Kite Mark Board 32
3.4 Proposals for an auto-enrolment kite mark 32

Section 4: Conclusion 34

Acknowledgements 35
Acknowledgments concerning the quantitative modelling 36
About PensionMetrics:
The Optimal Design of Defined Contribution Pension Plans 37
About the Pensions Institute 38
Previous Pensions Institute Reports 39

About the Authors

Debbie Harrison
Dr Debbie Harrison is a Senior Visiting Fellow at the Pensions Institute at Cass Business School.

David Blake
Dr David Blake is the Director of the Pensions Institute and Professor of Pensions Economics at Cass Business School.

Kevin Dowd
Dr Kevin Dowd is a Partner in Cobden Partners, Professor of Finance and Economics at Durham University, and a Fellow of the Pensions Institute at Cass Business School.

List of abbreviations

ABI	Association of British Insurers
AMC	Annual management charge
CIO	Chief Investment Officer
DB	Defined Benefit
DC	Defined Contribution
DWP	Department for Work and Pensions
FCA	Financial Conduct Authority
FSA	Financial Services Authority
GPP	Group Personal Pension
IFA	Independent Financial Advisor
IMA	Investment Management Association
NAO	National Audit Office
NAPF	National Association of Pension Funds
NEST	National Employment Savings Trust
ONS	Office for National Statistics
RDR	Retail Distribution Review
TCF	Treating Customers Fairly
TER	Total Expense Ratio
tPR	The Pensions Regulator

Sponsor Statement by NOW: Pensions

NOW: Pensions commissioned this report from the Pensions Institute at Cass Business School because we believed it would highlight some of the problems which UK employers will face in providing their employees with a good retirement income from auto-enrolment – and would make recommendations on how to overcome these problems. We believe this report offers a step-changing approach for UK pensions, and, if the recommendations are taken up, should lead to better retirement prospects for all employees.

For too long many UK employees have suffered from high-charging pension schemes with choices (and charges) that are difficult to understand and which do not deliver what members expect. Auto-enrolment has arrived, and this means that every employer in the UK will have to offer a pension – and every employee will be automatically enrolled in the scheme of their employers' choice over the next 5½ years. Employees should therefore be able to look forward to a more comfortable retirement. They should be able to contribute (and see their employer contributing) safe in the knowledge that they will get a pension which is good value for money and does not suffer from undue uncertainty.

However, the findings of the report demonstrate it is not as simple as that. There still exist many pension schemes which, whilst compliant with the new auto-enrolment regulations, are not truly fit for purpose today. They have high charges and the investments are too volatile. In short, they stand little chance of delivering a satisfactory pension.

The good news is that this could change, if the findings of this report are taken seriously, and the recommendations are acted upon.

The report shows that the level of charges is a key factor in the long-term performance of an employee's pension entitlement. It finds that, whilst the employee is ultimately the customer, it is the employer who chooses the pension arrangement and hence is the buyer – so the philosophy of "caveat emptor" (buyer beware) will not work. The onus should be on the seller, or the scheme provider – to take responsibility for ensuring that the scheme delivers.

As part of this, NOW: Pensions supports the recommendation of this report that schemes which meet high standards in respect of charges, investment of default funds and governance should be able to qualify for a kitemark, so that employers, on whose shoulders it falls to select a scheme for their workforce, can select a scheme with a kite mark with the comfort that they are selecting what should be a good quality arrangement – and be shielded from any future accusations that they did not exercise due diligence in selecting a scheme.
It will also give employees confidence that their employers have chosen an appropriate pension scheme for their needs.

Importantly, the report recommends that employers should take the opportunity of the new pension environment to review their current scheme, in light of the enormous impact that charges have on performance.

Pensions should do what they say on the tin – provide a lifetime income in retirement that is fair value relative to the contributions paid. We believe the recommendations set out here should be studied by consumer and employee representatives, employers, government and pension providers, in order to ensure that those whom pensions are set up to serve – the customers – actually get the pension they deserve.

We would welcome discussions with our competitors and other interested parties, and look forward with interest to hearing reactions to this excellent report.

Chris Daykin,
Trustee Director, NOW: Pension Trustee Ltd, UK Government Actuary (1989-2007)

Morten Nilsson,
Chief Executive, NOW: Pensions

Foreword

The Pensions Act 2008 introduced a requirement for private sector employers to auto-enrol all qualifying employees into a workplace pension scheme. With the demise of defined benefit (DB) schemes, employers will use contract- and trust-based defined contribution (DC) schemes for this purpose.

Auto-enrolment began in October 2012 with the biggest employers and concludes in 2018 with the smallest. A key regulatory requirement is that qualifying schemes must provide a default investment fund. This is because schemes cannot insist that auto-enrolees make an investment choice, since they have not actively chosen to join the scheme in the first place. There is also a requirement that there should be no advisor or consultant charge deducted from members' funds where only the minimum contribution is paid.

Auto-enrolment is a hugely ambitious experiment on the part of the UK government. Its objective is to ensure that all private sector employees – with the exception of the very low earners – build up a private pension to supplement the state pension. While the government sets the rules and regulations for auto-enrolment (policy), it is wholly dependent on private sector providers and advisors for the supply and distribution of schemes via employers to employees (delivery).

The introduction of auto-enrolment coincides with the introduction in January 2013 of the retail distribution review (RDR), which bans sales commission on new schemes sold from 1 January 2013. As the report explains, the unintended consequence of these two new regimes is an advice gap in the smaller employer market, which – unless addressed – is likely to lead to member detriment.

This report analyses the DC default funds used for auto-enrolment from two main perspectives. The first is qualitative and considers the impact of the behavioural traits of sellers (the providers, consultants and advisors that determine the fund design and the supply and distribution chain) and buyers (employers and trustees on behalf of the employees auto-enrolled). The second is a quantitative analysis of the impact of charges and asset allocations on the size of pension outcomes in different default funds. A number of existing and new schemes are modelled using appropriately calibrated stochastic simulation models.

There are about 205,000 DC schemes in the private sector: 160,000 of these are contract-based and 45,000 are trust-based. In aggregate, only 10,000 – approximately 5% – have more than 100 members. According to the market analyst Spence Johnson, these smaller schemes account for 40% of assets.[1] This fact alone tells us that most schemes are too small to be efficient, while recent research from the National Association of Pensions Funds (NAPF) and the multi-employer scheme provider B&CE tells us that many smaller employers are not even aware of the charges members bear, which raises important questions about the clarity of the disclosure of charges at the point of sale.[2]

1 For DC market analysis see Spence Johnson's 'Broad Brush' reports, in particular numbers 7 and 10: www.spencejohnson.com/TheBroadBrush.html

2 www.napf.co.uk/PolicyandResearch/DocumentLibrary/0261-Telling-Employers-about-DC-Pension-Charges-Research-Conducted-by-IFF-for-NAPF-and-BandCE.aspx

Until the arrival of modern 'multi-employer' schemes – by which we mean schemes that are available to all employers irrespective of size and membership profile – members in smaller schemes generally have paid up to six times (if not more) the annual charge that applies to those in the largest schemes, which makes the member outcome a lottery.

The results of our quantitative modelling demonstrate that charges are the most important determinant of the size of the final pension. Conventional wisdom in the DC market suggests that you get what you pay for: that higher charges are rewarded by better investment performance. In general, this is simply not true. While there might be a very small number of specialist fund managers who deliver above-average performance for a limited period, they are unlikely to be managing the assets of employees with lower and median incomes – the target market for auto-enrolment.[3]

Data on workplace DC schemes are unreliable. In a trust-based scheme, leavers are formally categorised as deferred members and therefore remain with the scheme and are captured within scheme membership data.

By contrast members who leave a contract-based scheme are re-categorised as individual personal pension customers. We were told that about 80% of job changers do not transfer their previous pots to their new workplace scheme and in the case of contract-based scheme members there is no audit trail that facilitates tracking the charges they pay as 'retail' customers, even though we know that in many cases 'deferred' charges applied to these customers are as much as twice the level of charges for 'active' members (those still working for the employer that provides the scheme).

In 2012, the DC workplace market is valued at £386bn.[4] Estimates indicate that the total number of active and deferred members of workplace DC schemes is between 3m to 5m. We do not know for sure, but we believe that this large variation in estimates is due to the reclassification of 'deferred' memberships of contract-based schemes as retail customers.

An estimated 10m employees will be auto-enrolled into workplace pension schemes over the next six years. Some will opt out. The government expects about 20% to do so; the industry suggests this figure might be much higher.[5] Given this uncertainty we suggest that by 2018 total membership might be in the region of 11-13m. The Pensions Regulator (tPR) expects this massive influx to increase aggregate contributions to DC by £9bn per annum, although alternative sources put the figure much lower.[6]

3 For evidence of this in the context of UK pension fund investment, see both Blake, D, Lehmann, B, and Timmermann, A. (1999), 'Asset Allocation Dynamics and Pension Fund Performance', Journal of Business, 72, 429-61 and Blake, D., Rossi, A., Timmermann, A., Tonks, I., Wermers, R. (forthcoming), 'Decentralized Investment Management: Evidence from the Pension Fund Industry', Journal of Finance.

4 Sources: Spence Johnson and ONS

5 According to the NAPF's 'Workplace Pensions Survey', March 2012, up to 33% might drop out. www.napf.co.uk/PolicyandResearch/DocumentLibrary/0220_NAPF_workplace_pensions_survey_-_March_2012.aspx

6 www.thepensionsregulator.gov.uk/docs/delivering-successful-automatic-enrolment.pdf

The workplace DC market is already heavily subsidised by government tax incentives, paid for by the taxpayer, and worth about £8.5bn in 2010-11.[7]

Auto-enrolment will boost DC assets under management significantly and therefore in theory represents an extraordinary business opportunity for private sector providers and advisors. But they have not embraced this opportunity wholesale. Due to targeting (by employers, consultants, advisors and providers), under the system of voluntary participation that preceded auto-enrolment, scheme members tended to be above-average earners and longer-stayers. This meant that they paid higher than average contributions and were likely to continue making contributions due to a more established career structure. These characteristics made the voluntary market very profitable for all parties concerned in the provider and advisory markets. Auto-enrolled memberships will reflect the working population as a whole, which, in the industry's own terminology, risks 'polluting' profitable schemes.

Employers that do not have access to advice, because their economic and demographic profile is 'polluted', fall into two categories. The first can be described as a 'greenfield' site, in that there is no scheme at present (other than an empty stakeholder box). It is to be hoped these employers will find their way to the low-cost multi-employer schemes, but they will need clear signposts. The second is a 'brownfield' employer which is likely to have been sold a contract-based scheme in the 1990s or early 2000s, with a total member charge of 2-3% of assets under management. Unless these employers are told otherwise, they will use their existing schemes for auto-enrolment. If this happens, millions of members will suffer detriment. We argue that this problem can be prevented if the government, regulators and industry act now.

It is frequently said in financial circles that the main problem with DC is low contributions, not high charges. We fully endorse the argument that people must save more to provide for their pensions, but the issue of charges should be sorted out first; otherwise, we are asking employers and employees to 'buy blind' and waste precious financial resources.

We would like to thank the many organisations and individuals who helped with this research. Those who were happy to be mentioned are noted in the acknowledgements.

We would particularly like to thank Now: Pensions for sponsoring this report. The views expressed in this report are those of the authors, not necessarily those of Now: Pensions or the Pensions Institute which takes no policy positions. Now: Pensions did not seek to influence our views in any way.

Debbie Harrison, David Blake and Kevin Dowd, *October 2012*

---

7 'Estimated tax relief for employer sponsored, private sector defined contribution pension schemes, in 2010-11', in NAO, Regulating Defined Contribution Pension Schemes www.nao.org.uk/publications/1213/defined_contribution_pensions.aspx

Findings

1. Our investigation of pension providers, consultants and advisors reveals a dysfunctional market that can lead to severe member detriment, especially for employees in smaller companies.

2. Data on workplace DC schemes are unreliable because contract-based providers recategorise scheme leavers as retail customers - this is, they are no longer part of the scheme. This makes it impossible to analyse what happens to 'deferred' member charges.

3. Thousands of employees pay six times the annual charge that is available from the modern multi-employer schemes – a total expense ratio (TER) of up to 3% p.a., or even more, compared with a long-term TER of 0.5% or less for these new schemes.

4. For a number of providers, there is a lack of clarity over charges and what precisely is included in the TER. Our research encountered examples of what can only be at best described as 'disingenuous practices' in respect of charge and cost disclosure on the part of some providers and advisors. These unfairly distort competition and strongly influence the 'choice' of schemes employers purchase.

5. Our findings from the quantitative analysis show that the retirement incomes of these in the high-charging schemes will be worth only about an average of 50% of the income achieved by members in low-charging schemes after 40 years of membership.

6. Our quantitative analysis also showed the default funds used for auto-enrolment had very different risk and return profiles, with the highest-risk funds producing around 50% of the retirement income produced by the lowest-risk funds in the worst-case scenarios that we modelled, according to the downside risk measure we used.

7. High charges are disguised by massive complexity, but also by the Financial Services Authority (FSA) projection rates, which are unrealistically optimistic relative to performance post-2000 and are likely to remain so even when revised.

8. Unless older high-charging schemes are abolished, their use for auto-enrolment – when up to 10m low- to median-earners often with low financial literacy join DC schemes – will lead to the UK pensions market facing a mis-selling scandal on an unprecedented scale.

9. The long-term TERs of 0.5% or less for new schemes are the charges that members will pay if they remain in the scheme for a long period of time (at least 7-15 years). If they only stay for a short period, the effective charges they will pay will be much higher in schemes with a dual charging structure (e.g., in the case where the scheme has a charge on both contributions/administration and assets under management).

10. The extent of vested interest as well as the embedded behaviour or conduct of market participants suggests that the market will not reform itself in relation to older contract-based fund charges.

11. Charges are not regulated by the FSA or the Pensions Regulator (tPR); charges do not appear to form part of the qualifying scheme compliance process.

12. Advice to employers is not regulated by the FSA and tPR. This is a massive oversight on the part of the regulatory system.

a. Caveat emptor and the FSA's 'treating customers fairly' (TCF) regime assume that buyers understand the cost of their purchases. This is not the case, especially for smaller employers.

b. Auto-enrolees are the customers but they are not the buyers because they are auto-enrolled into a scheme bought by an employer that might not understand the impact of charges. Auto-enrolees, therefore, are 'buying blind'.

13. Large employers with professional advice have the scale and negotiating power to drive down charges. The same is true of the new trust-based multi-employer schemes. Smaller employers are disadvantaged by the supply and distribution system:

a. Those with high staff turnover and a significant proportion of lower earners do not have access to professional advice. They are perceived as unprofitable ('polluted' in the industry's language) by most advisors and life offices.

b. If these employers happen to find their way to one of the new low-cost multi-employer schemes, members are likely to end up with a bigger pension relative to contributions compared with employees in existing high-charging life office funds.

c However, there is no automatic default position for these employers that directs them to the most appropriate schemes. Under the original blueprint for auto-enrolment, this would have been the government-sponsored National Employment Savings Trust (NEST), but industry pressure stopped this.

14. Even where employees are auto-enrolled into a low-charging scheme for future service, their older pension assets will continue to languish in high-charging funds due to a dysfunctional transfer market for contract-based schemes.

a. Exit charges act as a massive barrier to transfers, which means that members are trapped and frequently pay even higher charges when they stop contributions.

b. 'Schemes' are in fact a series of individual contracts. This means that every member has to sign a transfer form – an extensive exercise that requires considerable communication and information resources, which smaller employers in particular do not have.

Recommendations

1. Caveat venditor

a. Caveat venditor – let the seller beware – represents a more appropriate principle than caveat emptor – let the buyer beware – for members of auto-enrolment DC default funds and should be the overarching framework for auto-enrolment.
b. This requires robust governance frameworks that embed a fiduciary duty to put members' interests first.
c. Caveat venditor should apply to all schemes irrespective of whether they are trust- or contract-based and whether they are run by providers with shareholders or not-for-profit organisations.

2. There should be a commonly agreed definition of the total expense ratio (TER) (or ongoing charge as it will be known in future).

The TER should include:

- annual management charge (AMC) by the investment manager
- additional fund expenses in relation to specific delegated charges not covered by the AMC (e.g., custodian fees; fund administration fees; accounting and auditing fees; valuation fees; distribution fees; legal and regulatory fees; directors' and advisors' fees)
- all costs relating to scheme administration and member record keeping, whether these be expressed as a monetary or a percentage figure.
- advice to the employer or trustee, where this forms part of the member charge

Any separate advisory fees invoiced by the consultant, but paid for by the employer/trustees rather than the member should be excluded from the TER calculation, because it is too difficult to assess whether the member is being impacted by these fees (for instance via a lower employer contribution rate).

3. The high charges on legacy default funds should be eliminated

The high charges imposed by the older default funds which started in the 1990s or earlier should be eliminated voluntarily or via regulation.

a. The starting point for the Pensions Regulator would be to reject, for scheme qualification purposes, any scheme that has high long-term charges relative to those offered by the new trust-based multi-employer schemes which have an annual long-term TER of 0.5% or less.
b. The same point applies to default funds that impose exit charges, as this undermines the portability of member funds and therefore does not reflect the needs of the modern workforce.
c. The government and regulators urgently need to consider the solution to member assets trapped in these older schemes due to exit penalties.
d. They also need to consider changing the remit of regulators so that they can regulate charges explicitly.

4. A 'scheme' should be a 'scheme', not a series of individual contracts

a. The reclassification of contract-based workplace arrangements as 'schemes' would facilitate bulk transfers of members' assets to lower-cost schemes.
b. This would also make workplace DC market data more transparent and therefore subject to greater scrutiny.

5. **A kite mark should be introduced for schemes that serve the 'direct-to-employer' market and to accommodate 'refugees' from older high-charging schemes**

a. The current (long-term) TER of 0.5% or less, established by modern multi-employer schemes, would seem to be an appropriate target for the auto-enrolment market as a whole.

b. This target should form the basis for a kite mark for schemes that have good investment governance built in, and which can be purchased by employers directly, without the need for advice, which adds to member costs and in the case of smaller employers might not be available.

c. Kite-marked schemes should be available via a central website.

d. They should be promoted as the natural home for smaller employers in particular that are new to the market, and used for transfers for employers with older high-charging schemes.

6. **Regulatory Reform**

The current dual system of regulation whereby the Pensions Regulator regulates trust-based schemes and the FSA regulates contract-based schemes should be reformed.

7. **Advisors to employers should be regulated in the same way as advisors to individuals**

a. In order to close a loophole that leads to member detriment, the FSA – and, from 2013, the new Financial Conduct Authority (FCA) – should regulate advice to employers in the same way in which they regulate advice to individuals. Employers – particularly in the smaller company market – cannot be regarded as informed institutional purchasers and their decisions can result in unacceptably high charges for their employees.

b. To improve their ability to regulate 'conduct' more effectively, the FSA and FCA need to have a much better understanding of the behavioural traits – identified by us in this report – exhibited by the industry they regulate.

8. **Projection rates should be credible**

a. When the FSA revises its projection rates for DC and other long-term investments, these should be credible and not give the false impression that members can expect a fixed return of 8% (or whatever the new projection rate is).

b. Triennial reviews would help to ensure projections remain on track.

9. **Projections should be presented in a way that is meaningful to members**

Projected outcomes for DC default funds should be presented in a way that is meaningful to members, such as in the form of a projected real income in retirement or a replacement ratio, rather than in the form of a projected return on the fund or a projected fund size at retirement.

10. **A measure of downside risk should be presented**

Alongside a projected performance measure such as the projected real income in retirement or the replacement ratio, DC default funds should report a downside risk measure

11. **The quality of data about the workplace DC market should be improved**

There needs to be considerably more high quality data made publicly available about the workplace DC market.

1 How The DC Scheme Market Works: A Qualitative Evaluation Of The Behavioural Traits Of Sellers And Buyers

The new market for auto-enrolment began on 1 October 2012. Employees who are not in a workplace pension scheme will be auto-enrolled into a defined contribution (DC) pension scheme established by their employer. In this section, we describe how the current DC scheme market works in practice, using a combination of analysis of publicly available information, investigation of regulatory regimes, and anonymised interviews with industry participants. This allows us to shed light on how the market works in practice. Of particular importance are the behavioural traits of both those selling into the market and those buying from the market. Our findings here will help to inform the recommendations we make in Section 3 of the report. We begin by explaining 'what is auto-enrolment?'

1.1 What is auto-enrolment?

The Pensions Act 2008 introduced new pension duties for private sector employers. Starting with the largest employers in 2012 and ending with the smallest in 2018, the Act requires employers to automatically enrol qualifying employees over the age of 22 into a designated pension scheme. The date at which the new duties take effect will depend on the size of the employer's pay-as-you-earn (PAYE) scheme.[1]

The policy aim of auto-enrolment is to ensure that employees build adequate private pension provision. By 2018, there will be more than 1m new employers providing pension schemes. Up to 10m new employees will be auto-enrolled, but they have the right to opt out. However, if they do so, they will be re-enrolled every three years. Employers are not permitted to offer inducements to encourage employees to opt out.

Auto-enrolment applies to workers ('eligible jobholders') who:

- Are not already in a qualifying workplace pension scheme;
- Are at least 22 years old;
- Are below state pension age;
- Earn more than £8,105 a year; and
- Work or ordinarily work in the UK (under their contract)

The rules require total minimum contributions of 8% based on earnings between £5,564 and £42,475 ('qualifying earnings') in the 2012/13 tax year. This 8% total comprises a contribution of 3% from the employer, 4% from employees and 1% tax relief.[2] Employers can choose to set higher minimum contribution levels.

Almost without exception, auto-enrolment schemes will be DC, which means that members will bear the investment and longevity risks and, in most cases, the total costs associated with asset management, the delivery 'platform', the advice to the employer or trustee (if there is one), and the administrative costs. These

1 www.thepensionsregulator.gov.uk/employers/staging-date-timeline.aspx

2 The contribution requirements will be phased in starting with a minimum of 2% of qualifying earnings, of which the employer must pay a minimum of 1%.

schemes can either be trust-based (run by a board of trustees) or contract-based (run by a provider such as an insurance company). Employers can use a new scheme specifically set up for the auto-enrolment regime or they can use one of the existing schemes that have been in place since the introduction of personal pensions in the late 1980s.

To qualify for regulatory approval – a process overseen by the Pensions Regulator[3] – an auto-enrolled scheme must provide a default investment fund to accommodate the majority of members who do not want to make investment decisions. In aggregate, an estimated 90-97% of members will use the default fund and in some cases the figure will be 100%.[4]

1.2 Who is the customer?

An important question for the regulators is 'who exactly is the customer?'. This question is particularly important in the case of contract-based schemes, where the contract is between the member and the provider. Here the employer is the buyer, but not the customer; the member is the customer, but not the buyer, and therefore has no influence over the choice of scheme to which he or she is passively auto-enrolled.

The employer has no responsibility for member outcomes, in law or in regulation. By contrast, in a trust-based scheme, the contract is between the trustees and the provider, and the trustees' primary role is to undertake a legal and regulatory duty to put members' interests above all other considerations (although it is important to note that in practice the expertise of trustees varies considerably).[5]

Under a contract-based arrangement, the employer might take advice, but the advice is not regulated. This is despite the very low levels of employer knowledge and understanding, as revealed in 'Telling employers about DC pension charges', published in September 2012 by the NAPF and B&CE.

The cost of advice – agreed by the employer with the advisor – typically is passed on to the member, even though the member generally has no say in this agreement and no contact with the advisory firm. This cost, which might take the form of an upfront fee or commission plus annual 'trail' fees/commissions (paid annually from year two of the contract), is deducted by the provider from the member's assets and usually lasts for the lifetime of the contract. One interviewee described this process, from an advisor-remuneration perspective, as 'commission without permission'. [6]

3 www.thepensionsregulator.gov.uk/employers/explaining-qualifying-schemes.aspx

4 This is the figure common in other countries with auto-enrolment, such as Sweden.

5 In a trust-based scheme, members effectively have their own accounts – so although legally, trust and contract are different, from an administration and accounting perspective, they operate in the same way in that all members have their own designated pots.

6 Commission will not be permitted for sales of new schemes with effect from 1 January 2013. Existing arrangements will be able to continue to operate on a commission basis. Moreover, new fee arrangements in many cases appear to mirror commission rates.

A minority of financially sophisticated scheme members might examine the scheme charges and decide they are excessive. Under auto-enrolment, they have the right to opt out of the company scheme and to buy personal pensions instead. However, in this case, the employer contribution almost certainly would be lost, since it is under no obligation to pay contributions to alternative arrangements established by opt-outs.

1.3 The supply and distribution chain

The government is heavily dependent for the delivery of auto-enrolment on an industry where powerful vested interests shape behaviour ('conduct' in regulatory terms) in the supply and distribution chain. Due to fierce competition in the auto-enrolment market, new schemes generally offer better value for money than the older schemes.[7] However, vested interests - and also the challenges of revising contract law retrospectively - present major challenges for the reform of the tens of thousands of older schemes that are still likely to be used for auto-enrolment and which have high charges relative to what seems to be an achievable long-run target TER of 0.5% or less established by schemes that are open to all employers.

The employer's or trustees' 'choice' of scheme and fund is dictated by the idiosyncrasies of the supply and distribution chain in the DC market, which, until the advent of the new multi-employer schemes, was determined by the demographic and economic profile of the potential membership. It so happens that the highest charges have fallen on scheme memberships characterised by lower-earners and high staff turnover.

In our 2004 report,[8] we said that most advisors and providers had withdrawn from companies with fewer than 50-100 employees, due to the negligible profit margins. Where an employer was considered economically marginal, advisors and providers imposed an above-average member charge to compensate for lower contributions and higher lapse rates due to staff turnover.

Under auto-enrolment, these considerations apply but in slightly different ways. Interviewees said that large firms of advisors and the major life offices still do not want the unprofitable sections of employees because, we were told, these memberships would 'pollute' profitable schemes. To avoid these, they cherry pick: they separate out the profitable memberships for themselves and place the 'polluted' sections in a multi-employer scheme designed for the mass market. A consultant explained to us: 'for the polluted section of a workforce, our job is not to provide a pension, but to administer auto-enrolment requirements. There is no embedded value in this section of the market'.

It will be very interesting to see the results of these cherry-picking exercises in due course, when it will be possible to compare the outcomes of members in

---

7 In June 2012, the stated average life office annual management charge (AMC) for new business was in the range 0.5-0.7% for active members, but this does not include the cost of advice. The lowest TER we discovered for contract-based schemes sold through an advisor in 2012 was 1%. www.abi.org.uk/Publications/62708.pdf

8 www.pensions-institute.org/reports/deliveringDC.pdf

the contract-based life office funds and in the trust-based multi-employer funds. Our quantitative modelling results, presented in Section 2, indicate that the latter will get better value – in some cases significantly so – relative to contributions paid.

Auto-enrolment rules do not allow the advisor to deduct a charge from member funds where only the minimum contribution of 8% is paid. We were told that many employers will not pay an advisor fee, which means that in effect their employees will be disenfranchised from the scheme advisory market. In the absence of advice, employers that already have a scheme are likely to continue to use this for auto-enrolment.

In theory, local and regional independent financial advisors (IFAs) might cater for smaller employers, but we understand that their expertise is largely in the retail market and that they are unlikely to have the expertise in workplace auto-enrolment schemes. Moreover, under the Retail Distribution Review (RDR),[9] it will be more difficult for IFAs to secure the remuneration they need through explicit fees. The FSA makes this point on its website, somewhat ironically under 'Treating Customers Fairly' (TCF): 'firms are looking to move into a phase of growing revenue by attracting profitable customers and reducing unprofitable customers'.[10]

Consultants and advisors

Fee-based consultants and commission-based corporate advisors have both played an important role in the development of the workplace DC market. Historically, this market was dominated by the commission-based corporate advisors which sold contract-based and bundled trust-based DC schemes to smaller and medium-sized employers that did not want the cost and complexity of DB. From the turn of the century, when medium-sized and larger employers began to close their DB schemes, fee-based consultants became more involved in the market and sold DC to their corporate clients for members' future accrual.

We understand that today these two categories of advisor are difficult to distinguish when it comes to DC business. Some fee-based consultants charge commission (they might call it a 'fee', but in practice this is just a 'professional' way of restating the commission payment), while corporate advisors are moving to a fee basis in advance of RDR. Some corporate advisors have re-branded explicitly as 'consultants'.

Although corporate advisors and most consultants are FSA-regulated, such regulation does not extend to advice to employers. The FSA said that to address this oversight in regulation would require a change in its regulatory scope and this, in turn, 'would be a matter for the Treasury as the sponsoring government department'.

9 www.fsa.gov.uk/rdr

10 www.fsa.gov.uk/doing/regulated/tcf

Consultant-providers

Certain consultants have entered the DC market as scheme providers, whereby they construct their own scheme using one or more asset managers for the default fund and one or more life offices for the platform.

This development has proved to be very controversial because, as independent firms, consultants are assumed to advise and recommend schemes based on the whole of the market.

It is not clear if consultant-providers act in this capacity as discretionary asset managers, restricted-advice IFAs, or both, but in practice the difference between 'independent' and 'restricted' in these cases appears to be blurred, as is the boundary between 'consultant', 'provider' and 'asset manager'.

Interviewees said consultants are taking this step in order to retain their fee-earning role as default fund designers, which is lost if the asset manager or multi-employer scheme undertakes this role. They also said that the consultant-provider model creates market distortions in the employer's 'choice' where the consultant charged with selecting a scheme on an independent basis is also able to offer its own product.

> *This is a clear conflict of interest. If a consultant has its own product, it is effectively offering tied or restricted advice under RDR, so how can they claim to give independent advice?* Asset manager

1.4 Charges

The next important issue to consider is the way that member charges are calculated and the amount that is paid to the various parties to a scheme's design and delivery, including the consultants and advisors. Remuneration to consultants and advisors can be a very significant element of the overall member charge. This is particularly relevant in the light of the FSA's damning statement on sales bias, which is a result of the incentive systems employed by the firms it regulates.[11]

We recognise that in many cases consultants and advisors do an excellent job for the employers they advise, but this is not always so, according to interviewees:

> *When you look at the true cost of DC, you find that the consultant and advisor costs are equal to the asset management and platform costs combined. With good governance as part of the product, there's no need for a lot of advisors in the DC market; employers and employees would be better off – literally – without them.*
> Asset manager

We suggest that the rationale for high consultant and advisor charges should be re-evaluated. The old argument that was offered in the 1990s was that in a voluntary market, where many people did not appreciate the importance of private retirement savings, pensions had to be 'sold'. Providers, therefore, argued that they had to pay attractive commission rates to the intermediaries who undertook the job

11 www.fsa.gov.uk/library/communication/speeches/2012/0905-mw.shtml

of selling to what often was considered a tough and unwilling buyer.
Under auto-enrolment, this rationale no longer applies because employers are required by law to provide a pension scheme and all eligible jobholders automatically are 'buyers'.

The legacy of complex and high charges

High charges on older pension schemes emerged as the most serious concern in this research. Such charges were masked in the 1990s by the high equity returns experienced during that decade. They were also masked by the high projected investment return of 9%, which the FSA permitted companies to use in their illustrations and annual statements – and still does in 2012. The FSA is considering revising its projection rate for contract-based pensions to 8%, but this still looks high.[12] NEST, for example, has a target real (inflation-adjusted) return rate of 3%; even this looks optimistic going forward.

Charges for contract-based schemes sold before 2001 are extremely complicated and vary from provider to provider.[13] A unit-linked fund might have two up-front deductions (the 'allocation rate' and the initial 'bid-offer spread') which together could take the equivalent of 7-8% off the value of the units purchased. On-going charges include an annual management charge (AMC), which could be 0.75-1.5% of assets under management (AUM), plus the 'product management' fee of 0.5-1.5% of AUM for ongoing advice, on top of which there is a monthly policy fee of £3-£5. Old-style charges were calculated using the reduction-in-yield (RIY) methodology, but this did not include the impact of an exit (transfer) charge, which might be anything from 5% up to 25% or more, depending on the number of years the contract has been in force. Members who reduce or stop contributions, but leave their fund with the provider, rather than transfer out, also face higher charges. All of these charges are still in force in most older schemes.

Stakeholder schemes, introduced in 2001, initially had an AMC capped at 1%, but, after industry lobbying, this was raised in April 2005 to 1.5% for each of the first ten years that the contract was in force, after which it reduced to a maximum of 1%. Given poor persistency rates – historically most DC contracts lapsed in the first five-to-seven years – this means the effective cap from 2005 was 1.5% for stakeholder schemes.

Old charging structures continue in a new guise

Although explicit exit charges are no longer applied to new schemes, many providers charge scheme leavers a higher 'deferred member' charge, which can be double that of the 'active member' charge. Consultants and providers told us that employers like this charging structure because 'it keeps rates low for their employees – that is, the active members who matter – at the expense of leavers, who do not'.

Improvements for modern schemes but older schemes remain toxic

We understand that at present there is no regulatory cap for default funds

12 www.fsa.gov.uk/library/communication/pr/2012/065.shtml

13 See www.moneymarketing.co.uk/pensions/nic-cicutti-the-pension-industrys-dirty-little-secret/1055462.article

under auto-enrolment, nor is there any requirement for life offices to apply their modern charging structures to their back books, even if these schemes continue to be used and will be used for auto-enrolment. When stakeholder mono-charging was introduced, some providers said that they had applied the new charging structure to certain existing schemes, but clear evidence was not produced and interviewees for this research said that old charging structures are 'very much alive and kicking today':

> *The industry has done a lot in recent years to reduce the level of charges on pensions, and modern plans are considerably cheaper and therefore better value than older-style arrangements. Unfortunately, many of these old plans are still around and can be cripplingly expensive to escape from given the high exit penalties that are built in to them.* Advisor

Reducing charges would certainly cause problems for the life offices for several reasons. One is the sheer complexity of the task. A proportion of 1990s-style contracts have been acquired by insurance company aggregators, but a major life office with a history of mergers and acquisitions currently might have 20-30 different charging structures across its DC business. Moreover, it is important to note that these high charges also apply to the tens of thousands of small bundled trust-based schemes sold in the 1990s, which should be distinguished from the generally well-run trust-based schemes of the larger employers.

Probably the most significant reason for not reducing charges on back books relates to the frontloading of the costs incurred by life offices, in particular the need to recoup the high up-front sales commission to advisors, which often accounted for 35% of the members' contributions in the first year, and to maintain the annual 'trail' or ongoing commissions agreed at the point of sale.

In addition there is a huge challenge in attempting to revise contract law retrospectively:

> *We should not underestimate the difficulty of lowering charges for older contract schemes. Not only are the terms contractual, but the cash flows presumably support the embedded values of the institution. I don't know how material the sums are, but outlawing the charges looks fraught with difficulty. A voluntary offer by companies not to take the full charge may be a possibility and perhaps easier for a mutual.* Trustee

Therefore the decision for a life office to reduce charges on its older schemes is not an easy one, since, in many cases, this could lead to heavy financial losses, not just in terms of asset management profits, but also because providers are committed through established contracts to advisor commission agreements. One interviewee said:

> *It's a tough decision for life offices. They might want to clean up older fund charges, but if they do, some will go bust. For those that survive, there is a reputational issue – customers will ask why they haven't done this before and could claim compensation. The providers' dilemma is how to move forwards and still to protect the back book. The government and the regulators' dilemma is how to strike a balance between treating members of older schemes fairly and avoiding prudential concerns in the market.* Market analyst

The problem here is that the commission system that operated in the 1990s and early 2000s – when life offices 'bought' market share in what was described to us as a 'commission war' – left many financial advisors conflicted and might still do so today.

Moreover, the commission war has dominated distribution in the run up to auto-enrolment. In August 2012, the FSA reported a spike in sales of investment products that pay recurring trail commission[14] and there has been another commission war in advance of the Retail Distribution Review (RDR),[15] which replaces commission with fees for sales of new schemes after 31 December 2012.

Importantly, RDR only requires remuneration to be disclosed as fees. It does not require fee levels to be reduced, as one interviewee noted:

> *We share, with many others, concerns about the erosion of pension savings by the cost of advice to employers for staff pension schemes – consultancy charging being funded from pension savings. This has, of course, been brought to the fore by auto-enrolment, but is a feature of the wider employment-based pensions market. In the Financial Services Authority's policy statement 10/10, 'Delivering the Retail Distribution Review', it states that there is no reason why consultancy charges at the level of commission currently paid could not be deducted from the first year's contributions to a Group Personal Pension. A range of 10%-35% is referred to in the policy statement. This is an alarming prospect.* Trust-based multi-employer scheme

In the final quarter of 2011 and the first quarter of 2012, 102,000 and 103,000 group personal pension schemes (GPPs), respectively, were sold – an increase of 13% on the previous period.[16] The FSA said that it is unlikely these sales represent genuinely new schemes, but rather they are replacements for existing schemes. Commission agreements already in place by 31 December 2012 will continue under RDR and will also apply to transfers-in of members' assets from former employer schemes

The Association of British Insurers (ABI) has said that it is looking into the extent of exit charges in older funds, while pensions minister Steve Webb has warned insurers that their 'battered' reputation will be further tarnished unless they tackle the issue:

> *If people entered a contract 15 years ago on certain terms, unless you can show they were misled, it is very difficult for the Government to intervene. However, one might have a conversation with the industry and particular providers and ask whether certain exit penalties are something they still want to be associated with.*[17]

The government has threatened to use its powers under the 2011 Pensions Act to impose a cap on charges for new schemes and it is also considering banning deferred member charges. However, its powers do not appear to extend to charges for existing schemes and existing deferred members. As we note above, we imagine that this is because such an intervention would raise serious issues under contract law. Providers recognise the government's potentially weak position and remain extremely reluctant to address charges on older contracts. However, if the government did impose a cap going forwards, and if this was incorporated into qualifying scheme rules, then at least employers would not be permitted to use what might be described as 'toxic' schemes for auto-enrolment purposes

14 www.fsa.gov.uk/static/pubs/other/psd-retail-investment-2012.pdf

15 www.fsa.gov.uk/rdr

16 See note 26.

17 www.fsa.gov.uk/static/pubs/other/psd-retail-investment-2012.pdf

1.5 Design complexity

Another feature of the current DC market that emerged in the research is design complexity. Interviewees raised concerns about the ways in which providers and certain consultants promote overly complex scheme infrastructures. They said 'the prime purpose of complex delivery vehicles is to justify a higher consultancy commission or fee'. These concerns were also raised in the FairPensions report:

> *It may not always be in consultants' interests to help schemes control costs: on the contrary, they may benefit from advising towards complexity, since this increases the need for further costly advice … while this has driven up the costs of intermediation, it is questionable whether it has delivered better consumer outcomes.*

As the NAPF and B&CE report reveals, many employers either do not understand the implications of these charges for their auto-enrolled employees, or are at best agnostic. In the very worst cases, we understand that a minority of employers have taken a commission rebate – in other words, they have benefited directly from the higher charge imposed on members (more recently we have seen examples where providers offer to pay 50% of the employer's auto-enrolment contribution for the first three months). We were told that although in theory employers are discerning buyers, in practice 'even some of the larger employers are more concerned with the appearance of the scheme than with its substance'.

Platforms

'Platforms' are a relatively recent innovation and emerged as another controversial feature of the research.

A platform (confusingly, also known as a corporate wrap, corporate platform, benefits platform, benefits portal, and workplace savings platform, among other descriptions) is an IT interface between the member and the scheme, plus, in many cases, other employee benefits, including even bicycles. There are about 12 DC pension platform providers, such as Aegon, Aviva, Axa, Fidelity, Legal & General, Scottish Widows, Standard Life, and Zurich. The FSA has reported that platform charging is opaque in relation to consultancy and platform provider costs.[18]

While interviewees said that employers need an IT system to manage their pension and payroll functions under auto-enrolment, there was disagreement over the required level of member communications and modelling features, among others, that are incorporated into these systems. In practice, members of default funds are highly unlikely to use these features. Those concerned with the sell and buy sides paint quite different pictures:

> *Sophisticated employee education and engagement tools are a key part of many of the new platforms. Video, online tools and apps are making this new corporate platform the most visually interesting and potentially engaging of all platforms.* PlatForum [19]

18 www.fsa.gov.uk/pubs/policy/ps11_09.pdf

19 The Corporate Platform Guide, Employee Benefits, November 2011

Some employers – especially HR managers – get very excited about the visual impact of platforms. Has any independent research been carried out to establish how many employees actually use these facilities? Do they really help deliver better pensions to the majority of members in default funds? Independent trustee

Fund choice and the promotion of active selection

Several interviewees said that, with the exception of schemes designed for executives who receive individual advice, there is probably no need for more than a total of five different risk-graded funds, including the default fund. In practice, many schemes offer 50 funds with multiple managers for each asset class. We were made aware of preferential relationships between consultants, providers and asset managers that determine which funds appear on a platform. This would seem to represent a conflict of interests that serves the supply side of the market and not the customer.

Furthermore, interviewees expressed concern about schemes that regard a high level of active member investment choice as evidence of successful member engagement.

I worked for a major insurer in the 1990s, when many large DC plans still had, as a metric of success, the number of people who didn't use a default. I have always thought this drive to self-selection total cobblers – as a wise head of a US investment company put it, 'We can't all be our own CIO'. The problem is that some employers are still being encouraged to use this metric today. Consultant

In several schemes examined in the research, 50% of members made active investment choices, yet the membership profiles indicated very low levels of financial knowledge. It was suggested to us that this practice is not appropriate 'member engagement'; it encourages members to make potentially ill-informed decisions that they do not revisit and which can cost three or more times the charge of the default fund.

Interviewees also said that individual risk-profiling tools, used to guide self-selection, are no substitute for the professional investment governance of the default fund. The FSA has raised similar concerns.[20]

1.6 Regulatory bipolarity and opacity

The dual regulatory regime for DC is undoubtedly problematic, as the recent reports from FairPensions and the National Audit Office have observed.[21] At present, tPR governs trust-based DC and the FSA regulates contract-based DC, although tPR's high-level guidance applies to both. This gives rise to significant differences that are a cause for concern in relation to:

- The ownership of assets in the fund and how these can be transferred
- The identification of the fiduciary responsible for member outcomes, and
- The lack of transparent data on the contract-based market.

20 www.fsa.gov.uk/library/policy/guidance_consultations/2011/11_01.shtml risk

21 FairPensions: fairpensions.org.uk/press/whoseduty
NAO: www.nao.org.uk/publications/1213/defined_contribution_pensions.aspx

Ownership of assets and transfers

Under a trust-based scheme, the contract is between the provider and the trustees. The trustees are legal owners of the assets and have the power to transfer them to a new scheme without having to seek the permission of all the members. Under a contract-based scheme, the provider is the owner of the assets and has a separate contract with each member. This means that when an employer changes its scheme to a lower-charging model, each member must sign a document to transfer existing assets to the new arrangement. Typically only 15-20% of members do so. This is one of the main reasons why there are so many small pension pots trapped in high-charging funds.

As a result of what appears to be a regulatory loophole, tPR's involvement in overseeing contract-based schemes under auto-enrolment stops at the point a member leaves. This is because 'once a member leaves employment, the contract becomes an individual personal pension with no employer involvement'.[22] By contrast, under a trust-based scheme, the leaver is formally classified as a deferred member and therefore the trustees' oversight must continue. As employees have no choice in whether they are auto-enrolled into a contract- or trust-based scheme, it seems that the dual regulatory system embeds significant differences in the treatment of active members and leavers, which can result in very different pension outcomes.

Fiduciary responsibility for member outcomes in contract-based schemes

The second cause for concern relates to the thorny question of where the responsibility for the member outcome lies in contract-based schemes. The Department for Work and Pensions (DWP) – unintentionally – draws attention to this problem in its 'Guidance for Offering a Default Option', where it describes the way that responsibility in contract-based schemes is spread across a complex and potentially-conflicted range of entities:

> *The ongoing responsibility for the default option may vary between provider, advisor, fund manager, employer and governance committee in different situations and for different aspects of a scheme … For each stage [of the decision-making process: suitability for membership, design, charges, communication, monitoring, review], decision makers should consider who is accountable and assign responsibilities to the designated party as appropriate.*[23]

tPR and the FSA note the potential governance vacuum in contract-based schemes in their joint guidance, which says that employers 'may wish to put in place some form of ongoing monitoring on a voluntary basis'.[24] However, management committees for contract-based DC schemes adhere to no formal structure, their role is unclear, they are not recognised in law and regulation,

22 www.thepensionsregulator.gov.uk/guidance/guidance-employer-engagement.aspx

23 www.dwp.gov.uk/docs/def-opt-guid.pdf

24 www.thepensionsregulator.gov.uk/docs/TPR-FSA-guide-on-regulation-of-contract-based-schemes.pdf

and they have no formal powers. The regulators admit this point when they say 'a management committee generally has no legal definition and is a term used to cover a diverse and often not clearly defined group of arrangements set up by employers'. While tPR recognises the importance of member trustee training through its trustee services and Trustee Toolkit, there is no equivalent system for contract-based DC committee members.

A better governance framework for auto-enrolment exists in theory for trust-based schemes. We say 'in theory' because, although tPR places responsibility for member outcomes on the trustees, interviewees said that many trustees fail in this duty of care due to lack of expertise and time.

tPR has highlighted the low levels of trustee training and governance in smaller DC schemes.[25] It says that many trustees do not understand DC risks and are unable to judge the member charge in terms of value for money. Interviewees said that this issue also applies to larger schemes, where trustees might be preoccupied with managing the DB deficit.

Poor data on the contract-based market

Interviewees said they were frustrated by the lack of clear data on the contract-based DC market. They said that the FSA and ABI could help considerably with market analysis if contract-based data were categorised into workplace and 'genuinely retail', where the contract is bought by an individual via an independent advisor, for example. It was suggested that 'workplace' data should capture all contracts purchased through a workplace scheme. This would include deferred members – the contracts of leavers, for whom, at present, there is no audit trail to facilitate the scrutiny of the charges leavers pay.[26]

1.7 Caveat emptor or caveat venditor?

At present, about 80% of members use the default fund because they have no strong feelings about how best to invest their contributions. Therefore they rely on 'experts' to make the decision for them. Prior to auto-enrolment, the fund might not be labelled 'default', but it would still be where members' contributions would be directed if they did not make an active choice.[27]

As previously mentioned, under auto-enrolment, we expect the aggregate membership of default funds to be more than 90% of the total under auto-enrolment. Most of the new members will be financially unsophisticated low-to-median earners. Therefore they will be financially vulnerable. At present, under the FSA's 'treating customers fairly' regime for contract-based DC schemes, caveat emptor is assumed, which means that the customer should make every

---

25 www.thepensionsregulator.gov.uk/docs/role-of-trustees-in-dc-schemes-statement-oct-2011.pdf

26 The ABI data are only available to non-members who are prepared to pay an annual fee of almost £3,000.

27 Some older schemes required members to choose between three funds risk-rated as low, medium and high. Inevitably most selected 'medium risk', and this is the fund we have used as the default in our quantitative modelling exercise in Section 2.

effort to understand the product he or she purchases.[28]

Member vulnerability is best understood from recognising the behavioural traits to which many individuals are subject:

The inertia principle: The success of auto-enrolment, in terms of the target population covered, is predicated on member inertia. This is known as the 'inertia principle' and, when it is operating, means that employees will 'go with the flow' and not resist an action – such as auto-enrolment – taken by their employer on their behalf. As the FairPensions report, 'Whose duty?', said, 'harnessing inertia to increase pension saving is at the heart of public policy'.

The endorsement effect: The inertia principle is underpinned by an 'endorsement effect', which tells us that employees assume their employer has made the right decision on their behalf.

Fear of regret: The endorsement effect is strengthened by a third principle: 'fear of regret' which describes the well-established phenomenon that people are afraid of making a complicated choice because they worry they might get it wrong. So they stick with the default fund whether it is suitable for them or not.

Buying blind: Finally, in behavioural terms, there is an unquestionable difference between an individual (for example someone who is self-employed) who actively buys a personal pension from his or her advisor, and the employee who is passively auto-enrolled into the company pension scheme. The former can be identified in regulatory terms as an individual who is knowingly and voluntarily a 'customer', and who can be reasonably expected to consider the cost of the product he or she selects and purchases. Auto-enrolees will not knowingly and voluntarily purchase anything; they will accept on trust a product purchased for them by an employer or trustee, even though typically they bear all the costs. We call this 'buying blind'.

A great deal of emphasis is placed by sellers of pension schemes – providers, consultants and advisors – on the provision of member education and information. While financial education in the workplace is to be welcomed, it will not change the fundamental flaws that embed member powerlessness and vulnerability in the purchasing process described above.

The behavioural traits described above are crucial to the way funds should be designed for members of default funds. Accordingly, we suggest that the overarching principle for the default fund market under auto-enrolment should be 'caveat venditor': 'let the seller beware'. Caveat venditor describes the legal presumption that a seller makes certain warranties, including the implied warranties of merchantability and fitness for purpose. Merchantability requires the seller to recognise that it is better suited than the buyer to determine whether a product will perform properly. Fitness for purpose requires the seller to recognise it possesses knowledge and expertise that is superior to the buyer's and on which the buyer may reasonably rely. Caveat venditor, therefore, assumes the product will do what it says on the tin, which, in the case of an auto-enrolment default fund, is to produce a lifetime income in retirement that is fair value relative to the contributions paid.

28 www.fsa.gov.uk/doing/regulated/tcf

2 Quantitative Modelling Of The Default Funds' Investment Strategies And Charges

We investigated the after-charge investment performance of 8 categories of contract- and trust-based default funds sold between 1990 and 2012 and which are still in use. We measured performance outcomes in terms of the replacement ratio (RR) – the ratio of pension to final salary – that could be achieved by participating in each fund continuously for 40 years. We regard the RR as a far more meaningful performance measure than the fund size at retirement because it takes account not only of investment costs and risks during the accumulation stage of a pension scheme, but also of the cost of purchasing a lifetime inflation-linked annuity, which provides a guaranteed income for however long a scheme member lives. Any differences in investment performance in the various default funds will be due to a combination of differing risk exposures in the underlying investment strategies of the default funds and the charges that the providers of the default funds extract.

2.1 Assumptions made

We used the PensionMetrics (PM) model to conduct the analysis. Each year for 40 years, we assume for a typical male employee, who joined a pension scheme at the age 25 with a starting salary of £25,500 (approximately equal to average UK earnings), that 8% (consisting of a 4% employee contribution, a 3% employer contribution, and 1% tax relief) of qualifying earnings (earnings in excess of a threshold initially set at £5,500)[29] are put into one of the default funds. These contributions are then invested according to each default fund's prescribed investment strategy and de-risking glide path. Charges are deducted annually from each accumulating fund value at the appropriate total expense ratio (TER) for that fund.[30] At retirement, the whole fund is used to buy a real (inflation-protected) annuity at the current annuity rate.[31]

29 The threshold level of earnings for auto-enrolment were set at approximately £5,500 in 2012. This implies that in our example the first year's contributions are equal to 8% of qualifying earnings of £20,000 (£25,500 - £5,500), i.e., £1,600. We assume that both earnings and the threshold are indexed. This means that the contribution rate is equivalent to 6.2745% of gross earnings (i.e., £1,600 ÷ £25,500) in the first year.

30 The TER generally includes the cost of advice and asset management charges (plus indirect costs such as custody, auditing, record keeping and administration). It is still an incomplete measure of total costs, however, as it does not include the impact of trading costs on the fund and contract exit penalties. It is also important to note that the modelling assumes the employee stays in the same fund throughout the accumulation period. In practice this is unlikely because most employees change jobs several times during their career. The TER for short investment horizons can be much higher than for long investment horizons. Exit penalties on transfers and higher charges on 'frozen' pots, where contributions stop but the fund stays with the provider, will have a significant impact on the resulting pension.

31 We have assumed for modelling purposes that the full fund is used to buy an annuity to provide retirement income, even though every member has the right to use 25% of the fund to take a cash-free lump sum and that many of the default fund's de-risking glide paths assume that this right will be exercised (i.e., the glide paths end up with a fund which is invested 75% in bonds and 25% in cash). Our rankings are not sensitive to whether we assume that the whole or just 75% of the fund is annuitised. They are also not sensitive to whether the annuity is index-linked or not, although the starting amount of the annuity would be higher if a level annuity had been purchased instead of an index-linked annuity.

The PM model used 5,000 Monte Carlo simulation trials per fund where each trial involved a different trajectory for asset returns over the 40-year investment horizon. One key measure of interest is the 'mean RR' which is the simple average RR across all the 5,000 simulations for any given investment strategy. In other words, this is the RR that the plan member can expect if he chooses a given default fund. We label this measure RR^{Mean} below.

It is also important to examine downside risk exposure. The downside risk measure we chose is the 'RR at the 5th percentile' on the distribution of outcomes when all outcomes are ranked in order from worst to best. We label this measure $RR^{5\%}$. $RR^{5\%}$ is the value of the RR of the 250th simulation (out of 5,000) in the sequence of simulations ranked from worst to best. This means that 5% of the simulations have a RR at or below $RR^{5\%}$, while 95% of the simulations have a RR above $RR^{5\%}$. This, in turn, means that there is a 5% chance of getting a RR at or below $RR^{5\%}$ and a 95% chance of getting a RR above $RR^{5\%}$.This is a pretty standard measure of downside risk exposure.

2.2 The default fund spectrum

We consider eight different categories of default fund according to the vintage and type of fund. These demonstrate the development of DC in relation to asset allocation and charging structures since it first became popular as a workplace solution in the late-1980s/early-1990s.

The eight fund categories are as follows:

1. **1990s Balanced Managed**. These were the original default funds provided and managed by life offices in the 1990s. They would not have been labelled 'default' funds in those days, as this term was not in use formally until the turn of the century, but they served exactly the same purpose – as the fund into which members' contributions were directed if they did not make an active choice. The vast majority of these were contract-based, but there were also some small bundled trust-based funds.

2. **1995 Equities Only.** 100% equity funds were offered from the mid-1990s as an alternative to balanced managed funds.

3. **2005 Equities Only.** Lower-cost 100% equity funds which were offered from the mid-2000s.

4. **2000s Balanced Managed.** These funds are typical of the slightly more diversified balanced managed model used by life offices from around the turn of the century to the late-2000s. Such funds tended to be managed entirely by life office provider, but some incorporated third-party asset management.

5. **2012 Balanced Managed.** These funds are typical of the current life office offering, which is even more diversified than the previous model and more likely to incorporate third-party asset management components, as well as the provider's own funds.

6. **2012 Diversified Growth.** Diversified growth funds are more diversified – for example through the more extensive use of alternative asset classes – than the typical life office balanced managed fund.

7. **2012 Consultant-Designed Funds.** We include a number of examples of the new 'strategic blended' funds designed by consultants for the trustees of larger schemes.

8. **2012 Trust-Based Multi-Employer Schemes.** We include a number of examples of the funds used by modern schemes specifically designed for auto-enrolment, which can be accessed directly by employers, as well as introduced by advisors.

The two key features that influence our results are the charges and asset allocations (including the de-risking glide path). We comment briefly on these features.

2.3 Charges

In Section 1, we described the complex charging structures that result in a TER of 3% or more for older funds: charges of up to 4% were encountered in the research. Modern funds have much lower explicit charges, but, in some cases, these disguise higher implicit charges, as the recent Lane Clark & Peacock report discovered: for example in the case of diversified growth funds, where the cost of sub-funds could add 50% to the headline rate.[32] LCP's report also noted the different charges that apply to the same funds, depending on the access route. For example, a large trust-based scheme that buys a fund direct from the asset manager might pay less than half the charge a stakeholder scheme pays for the same fund. In addition, the impact of advisor fees and commissions is significant, as these can double the member charge.

A further issue that has a significant impact on the final pension is the impact of changing jobs. In our quantitative modelling, we assumed continuous membership of the same fund. In practice, most employees change jobs quite frequently and therefore will belong to several schemes. If a scheme uses a dual charging structure that favours long-stayers over short-term members, or if fund provider imposes an exit charges on transfers, clearly this will reduce the final pension. The same is true in the case of the common practice of increasing charges on funds where contributions cease, which continues today in the form of 'deferred member charges'. In short, job changes tend to lead to lower DC pensions (other things equal) – just like they do with DB pensions – challenging the supposed full portability of DC pensions, a key reason for their introduction in the 1980s. In practice, the promise of full portability has proved to be a false one.

We ignored exit charges in our modelling, since we assume that the scheme member stays for his whole career in the same scheme. The TERs that we modelled ranged from 0.5% p.a. to 3% p.a.

2.4 Asset allocation and the de-risking glide path

An important feature of the modern consultant-designed and trust-based multi-employer funds is the dynamic asset allocation process. Conventional life office models have a static asset allocation: it is fixed at the outset and does not change, except during the linear de-risking glide path in the five or so years prior to retirement (although de-risking was not common in the early days).

32 www.lcp.uk.com/news--publications/news/2012/pa/lack-of-clarity-on-dc-pension-fees-prevails-as-additional-costs-increase-total-charges-by-as-much-as-50perc-says-new-lcp-report--1/

Clearly, it is too early to judge the success of these new dynamic asset allocation strategies, but the principle of investment risk management in DC schemes – the equivalent of liability-driven investing in defined benefit schemes – is a sound one. This because it enables those responsible for governance to act promptly to address issues such as a change in the economic or investment climate, or a change in taxation or legislation. In addition, dynamic asset allocation can respond more flexibly to changes in member behaviour, for example a trend towards later retirement.

However, we need to distinguish between dynamic asset allocation strategies that are specifically designed to manage investment risks or respond to changes in member circumstances – and delivered through an agreed investment governance framework – and dynamic asset allocation strategies where the manager has full discretion. In the case of the former, there is a prescribed review process and the scope for potential adjustments to the asset allocation is limited; in the case of the latter, the asset allocation reflects the individual fund manager's judgement.

Our study only covers the former type of dynamic asset allocation strategies. Where such strategies are used, we have been given confidential access to the specific asset allocation strategy that the fund provider believes will be typical for each year of the plan. We were not made privy to the actual adjustment rules that would operate during the life of the scheme in response to realised returns. Accordingly, we had to use the same supplied asset allocation strategy in each of the simulation trials.

Another important trend in DC investment has been a greater use of diversification to reduce volatility. This is reflected in an increasing use of so-called 'alternative' asset classes, such as real estate, private equity, hedge funds, infrastructure and commodities. The funds that use these new asset classes are known as 'diversified growth' or 'new balanced management' funds. The new multi-employer default funds also market themselves as being better diversified than the older funds.

De-risking glide paths work in different ways, but the objective is the same: to switch member funds gradually into low risk assets, such as bonds and cash. Glide paths were traditionally linear and deterministic, but some of the more recent providers' glide paths – like the asset allocation strategy itself – are managed on a dynamic basis, so that de-risking takes place in the context of market movements. For schemes that target a specific annual return within a target date fund, this means that the glide path might start earlier or later depending on the realized performance of the fund in the preceding years.

2.5 Key findings from the quantitative modelling

Practitioners, almost without exception, argue that the quality of asset management is more important than the cost. Our modelling results tell a very different story.

Our first key finding is that there is a wide difference in RR^{Mean} across the different default funds. The worst performing fund was a 1990s balanced managed fund with a TER of 3%. This produced a RR^{Mean} of 14%. The best performing funds were the new 2012 trust-based multi-employer schemes and the consultant-designed trust-based schemes for large employers when modelled using a TER of 0.5%. These produced a RR^{Mean} of almost double that of the worst performer.[33] We found that the principal reason for the differences in RR^{Mean} across the various default funds that we examined is the differences in charges. The lowest charging funds are those associated with the trust-based multi-employer schemes and the consultant-designed trust-based schemes for large employers. The highest charging funds are those sold by life offices in the 1990s and early 2000s and still used as default funds under auto-enrolment.

Our second key finding is that there is a much wider distribution of outcomes in some default funds than others. This is reflected in the downside risk measure $RR^{5\%}$. The worst performing funds were the 1995 equities only funds with a $RR^{5\%}$ of 6%. The best performing funds were again the new trust-based multi-employer schemes and consultant-designed schemes with a $RR^{5\%}$ of approximately double the worst performing funds. Some of this difference will also be due to differences in asset allocation – some default funds take more risk than others in the expectation of generating higher returns – but some of the difference will be due again to charges.

33 The RR^{Mean} would have been higher in all cases if the member had chosen a flat rate annuity rather than an inflation-linked annuity. It would have been lower if the member had decided to take some of the accumulated pension fund as a cash-free lump sum.

3 Proposals For An Auto-Enrolment Kite Mark

> *Never in a million years will pensions be a high priority for smaller employers. They should have had an automatic default – NEST – but the industry lobbied against this and won. From an imperfect start, the government and regulators now need to drive employers and all older scheme assets to new schemes that have a kite-mark for investment governance and charges.* Independent trustee

> *Good governance has always been affordable and available to larger schemes, but it's now available to all employers through multi-employer schemes. Unless we get smaller and medium-sized employers into these, they will be stuck with high-charging default funds and we will have a two-tier system that embeds member detriment.* Consultant

3.1 The rationale for a kite mark

The commercial decision by consultants and advisors to avoid certain membership profiles leaves many smaller employers and their employees stranded. Unless these employers are given a very clear steer, those with existing schemes that have high charges are likely to continue to use them for auto-enrolment, to the detriment of member outcomes.

Several interviewees favoured the concept of a kite mark for schemes suitable for the direct-to-employer market. This would involve a code of practice and central website for schemes that demonstrate compliance with tPR's standards of investment governance and which have a TER capped at an agreed point or point range. We suggest that a TER of 0.5% (or even less) is a reasonable and achievable long-run target, but as we noted earlier in this report providers disagree how best to deliver low charges. Therefore consideration needs to be given to the relative merits of a simple single charge that applies to all members, irrespective of their period of membership, and a dual charging structure that favours the long-stayers over members who leave after just a few years.

At present, there is no automatic default scheme for employers. The original intention was for NEST to undertake this role. NEST was introduced as a result of concerns about a potential market failure under auto-enrolment, because at the time existing providers said they would not serve the uneconomic sections of the market.

Since then, several providers have entered the market with schemes that they say are available to all employers, irrespective of the size and profile of the potential membership. The default funds of some of these schemes produced replacement ratios that were well above the average.

3.2 Who will organise the kite mark?

A kite-marking system could be operated by an appropriate regulatory authority, but we understand that the government and regulators would be unwilling to undertake this role. Therefore we suggest that the kite mark requires the collaboration of appropriate industry organisations, such as the NAPF, the ABI and the IMA. Nevertheless, we believe the government and regulators should drive the process.

3.3 Role of the Kite Mark Board

1. The proposed kite mark code would be developed by a governing board that includes a majority of members with no vested interests in the DC market.
2. The board would be responsible for screening applicants, issuing the kite mark and providing an annual 'MOT' to ensure record keeping, investment governance and charges remain on track. For these purposes, the board would adopt or develop appropriate processes, including quantitative modelling methodologies and software.
3. The board would develop a central website for kite-marked schemes that includes clear generic information for employers, a simple template for scheme information, and annual performance figures based on the TER, among other features.
4. The board would help to develop and promote an industry code of practice for fast-track transfers in. This feature would be promoted on the website.

3.4 The draft kite mark code

To qualify for the kite mark, we suggest schemes must meet the following requirements:

1. The ability and willingness to work directly with employers.

2. Charges:
    a. A clearly stated and standard definition of the total expense ratio (or ongoing charge). The TER should include:
        - annual management charge (AMC) by the investment manager
        - additional fund expenses in relation to specific delegated charges not covered by the AMC (e.g., custodian fees; fund administration fees; accounting and auditing fees; valuation fees; distribution fees; legal and regulatory fees; directors' and advisors' fees)
        - all costs relating to scheme administration and member record keeping, whether these be expressed as a monetary or a percentage figure.
        - all consultancy charges, where these are incorporated in the member charge.

        Any separate advisory fees invoiced by the consultant, but paid for by the employer/trustees rather than the member should be excluded from the TER calculation, because it is too difficult to assess whether the member is being impacted by these fees (for instance via a lower employer contribution rate).

    b. The target charge – or range of acceptable charges – to be clearly set out.

    c. Agreement needs to be reached on the use of single and dual charging structures. Where dual charging structures are used, their impact must be shown over different investment horizons.

    d. The TER should be expressed in monetary terms per annum, as well as in percentage points, for an agreed range of typical member profiles, including those that pay the minimum contribution.

    e. There should be no difference in the charges that apply to active and deferred members.

f. Charges should be disclosed to new members to show the impact on fund at the expected retirement date.

g. Entry and exit charges should not be permitted.

3. A simple format should be designed to enable providers to demonstrate their investment governance processes.

4. Projections should be presented in a way that is meaningful to members, such as in the form of a projected real income in retirement or a replacement ratio, rather than in the form of a projected return on the fund or a projected fund size at retirement.

5. Alongside a projected performance measure, a downside risk measure should also be reported. The kite mark might consider specifying an acceptable level of downside risk.

6. An in-built selection and open market purchase system for members' annuities.[34]

7. A facilitated transfer-in process negotiated by the industry to accommodate members' previous schemes and plans. The exception to this requirement is NEST, which currently cannot accept transfers.

8. A facilitated transfer process between kite-marked schemes where members change jobs but remain within the kite-mark market. As more employers use kite-marked schemes, this system will provide members with genuine portability – the original objective of personal pensions.

9. Safe harbour status:[35]

   Kite-marked schemes should confer 'safe-harbour' status on employers, to denote that they have taken reasonable steps to reduce the considerable risks faced by members of DC schemes. By safe harbour, we mean that employers would not be responsible for member outcomes, as this responsibility would lie with the scheme.

   This type of provision exists in the US under the Employee Retirement Income Security Act (ERISA) of 1974,[36] whereby plan fiduciaries that comply with the qualifying default investment regulations are not liable for any loss that occurs as a result of such investments.

---

34 Our views on this point were set out in 'Treating DC members fairly in retirement?' and have not changed. We are pleased to see that even in the few months since the report was published, there have been further moves towards this more open model. In addition, as our report noted, we believe such models can be adopted by all schemes at no additional expense to the employer and the employee.

35 In the UK, it is possible that employers might assume there is an implicit safe harbour provision for NEST, which is potentially dangerous as we understand that such a provision does not exist in practice. Although NEST is not a government scheme per se, it was designed and introduced by the government to ensure that all employers would be able to find an appropriate scheme even where they are not considered an attractive prospect to traditional providers.

36 www.dol.gov/ebsa/regs/aos/ao2012-02a.html

4 Conclusion

We hope that policymakers and regulators will consider carefully the findings and recommendations in this report, but we recognise that policy and regulatory reform takes time, particularly if this requires consultation with the powerful market players upon which the government depends for the delivery of auto-enrolment.

But time is running out. The largest employers, which are required to introduce auto-enrolment in 2012 and early 2013, have already established their schemes. Due to their size and public profile, these schemes are likely to be well governed and have fair charges. The issues identified in this report apply mainly to the schemes already in use and likely to be used for auto-enrolment by smaller and medium-sized employers.

If a market fit for purpose for members of these schemes is considered a valuable objective, then we suggest that the industry might voluntarily focus on our proposed kite mark. An effective kite mark that is well promoted to smaller and medium-sized companies would help employers make effective choices going forward and also, through appropriate transfers of members' assets from older funds, help to eliminate many of the poor practices relating to charges and investment governance encountered in our research.

However, history shows that the UK financial services industry does not readily reform itself. If it fails to respond to our most powerful finding – that high charges have a devastating impact on member outcomes – then auto-enrolment, the flagship innovation for private-sector pension provision, supported by all political parties in the UK, will be a failure.

Fortunately, there is time to address the problem of high-charging funds being used for auto-enrolment purposes. We sincerely hope that the regulators and industry will work together to ensure this does not happen.

Acknowledgements

Alexander Forbes Consultants and Actuaries
AllianceBernstein
Allianz Global Investors
Association of British Insurers
Association of Consulting Actuaries
B&CE
Bestinvest
BlueSky
Lawrence Churchill
DCisions
Dean Wetten Advisory
Defined Contribution Investment Forum
Department for Work and Pensions
Dimensional
Mark Fawcett
Fidelity
Financial Inclusion Centre
Financial Services Authority
Financial Services Consumer Panel
First Actuarial
Friends Life
HM Treasury
Hymans Robertson
JLT
JP Morgan
Investit
Investment Management Association
Lane Clark & Peacock
Legal & General
LIFT-Financial
Mallowstreet
Members of Parliament
Mercer
National Association of Pension Funds
National Employment Savings Trust
NEST Corporation
NOW: Pensions
Office of Fair Trading
Office for National Statistics
Opalliance
Organisation for Economic Cooperation and Development
Paradigm
Partnership
PlatForum
Retirement Angels
RiskLab
Spence Johnson
The Actuarial Profession
The Pensions Network
The Pensions Regulator
Chris Wagstaff
Towers Watson
Worldwide Financial Planning

Acknowledgments concerning the quantitative modelling

Long-term capital market assumptions for the individual asset classes were provided RiskLab GmbH (RiskLab).

RiskLab is the investment and risk solutions advisor of Allianz Global Investors (Allianz GI) and is part of Allianz GI´s global solutions organization.

RiskLab provides its services to renowned national and international institutional investors such as pension funds, corporate clients, family offices, wealth managers, and mutual funds.

Allianz GI is the investment arm of Allianz SE, a multi-national financial services company.

RiskLab cannot and does not guarantee the accuracy, validity, timeliness or completeness of any information, calculation, or data made available in the study presented.

We are extremely grateful to RiskLab for providing these data.

PensionMetrics: The Optimal Design of Defined Contribution Pension Plans

PensionMetrics is a software tool that can be used to design the best defined contribution pension plan for a plan member. For a given set of risk factors, a stochastic simulation model is used to determine the likely outcomes of the pension in retirement for different contribution rates, investment strategies and retirement ages. The model takes account of all relevant member characteristics including age, gender, occupation, prospective retirement age, other savings and investments, and longevity. The model can also take account factors relating to the plan member's spouse such as age and occupation.

The key risk factors in the model are:

- Salary risk: uncertain future salary, which affects the contributions into the pension fund.
- Investment risks: those risks associated with uncertain investment returns in the pension fund.
- Interest rate risk, which affects both investment risks and the annuity rate at retirement.
- Inflation risk.
- Unemployment risk.
- Longevity risk: the risk of an uncertain future life time.

PensionMetrics has the following unique features:

- Fully integrates the accumulation and decumulation phases of a DC pension plan.
- Recognises the importance of taking account of the member's occupation and gender.
- Allows for a wide variety of accumulation phase or investment strategies.
- Allows for a wide variety of decumulation phase or post-retirement strategies.
- Allows for longevity risk.
- Uses fan charts to illustrate the range of possible outcomes.

For more information, please contact David Blake on d.blake@city.ac.uk

About the Pensions Institute

The objectives of the Pensions Institute are:

- to undertake high quality research in all fields related to pensions
- to communicate the results of that research to the academic and practitioner community
- to establish an international network of pensions researchers from a variety of disciplines
- to provide expert independent advice to the pensions industry and government.

We take a fully multidisciplinary approach. For the first time disciplines such as economics, finance, insurance, and actuarial science through to accounting, corporate governance, law and regulation have been brought together in order to enhance strategic thinking, research and teaching in pensions. As the first and only UK academic research centre focused entirely on pensions, the Pensions Institute unites some of the world's leading experts in these fields in order to offer an integrated approach to the complex problems that arise in this field. The Pensions Institute undertakes research in a wide range of fields, including:

Pension microeconomics

The economics of individual and corporate pension planning, long term savings and retirement decisions.

Pension fund management and performance

The investment management and investment performance of occupational and personal pension schemes.

Pension funding and valuations

The actuarial and insurance issues related to pension schemes, including risk management, asset liability management, funding, scheme design, annuities, and guarantees.

Pension law and regulation

The legal aspects of pension schemes and pension fund management.

Pension accounting, taxation and administration

The operational aspects of running pension schemes.

Marketing

The practice and ethics of selling group and individual pension products.

Macroeconomics of pensions

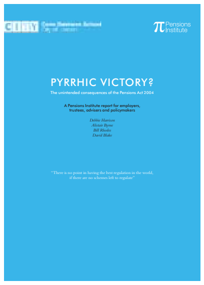
The implications of aggregate pension savings and the impact of the size and maturity of pension funds on other sectors of the economy (e.g. corporate, public and international sectors).

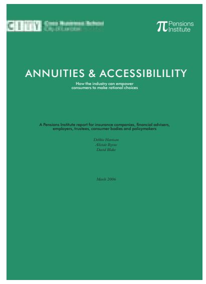
Public policy

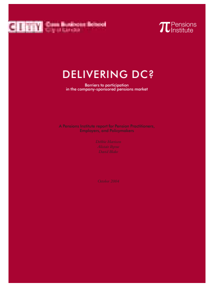
Domestic and EU social policy towards pension provision and other employee benefits in the light of factors such as the Social Chapter of the Maastricht Treaty and the demographic developments in Europe and other countries.

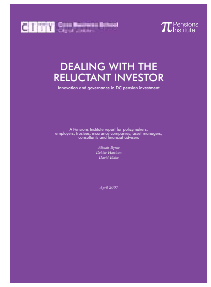
Research disseminated by the Pensions Institute may include views on policy but the Pensions Institute itself takes no institutional policy positions. For more details, see: pensions-institute.org

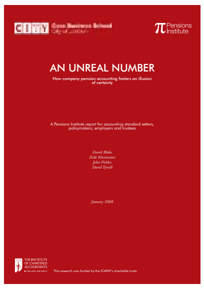
Previous Pension Institute Reports

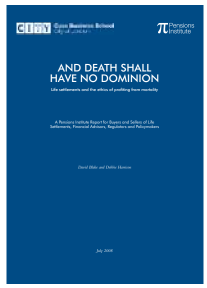


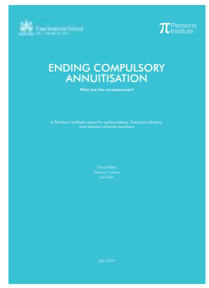












'Delivering DC? Barriers to participation in the company-sponsored pensions market', by Debbie Harrison, Alistair Byrne, and David Blake, October 2004.

'Pyrrhic Victory? The unintended consequences of the Pensions Act 2004', by Debbie Harrison, Alistair Byrne, Bill Rhodes and David Blake, October 2005.

'Annuities and Accessibility: How the industry can empower consumers to make rational choices', by Debbie Harrison, Alistair Byrne and David Blake, March 2006.

'Dealing with the reluctant investor: Innovation and governance in DC pension investment', by Alistair Byrne, Debbie Harrison and David Blake, April 2007.

'An unreal number: How company pension accounting fosters an illusion of certainty', by David Blake, Zaki Khorasanee, John Pickles and David Tyrrall, January 2008.

'And death shall have no dominion: Life settlements and the ethics of profiting from mortality', by David Blake and Debbie Harrison, July 2008.

'Ending compulsory annuitisation: What are the consequences?', by David Blake, Edmund Cannon and Ian Tonks, July 2010.

'Ending compulsory annuitisation: Quantifying the consequences?', by David Blake, Edmund Cannon and Ian Tonks, September 2010.