Growing Pension Capital

Lessons from Australia

Christopher Mahon and James Vitali

Foreword by Baroness Altmann CBE

Growing Pension Capital

Lessons from Australia

Christopher Mahon and James Vitali

Foreword by Baroness Altmann CBE

Policy Exchange is the UK's leading think tank. We are an independent, non-partisan educational charity whose mission is to develop and promote new policy ideas that will deliver better public services, a stronger society and a more dynamic economy.

Policy Exchange is committed to an evidence-based approach to policy development and retains copyright and full editorial control over all its written research. We work in partnership with academics and other experts and commission major studies involving thorough empirical research of alternative policy outcomes. We believe that the policy experience of other countries offers important lessons for government in the UK. We also believe that government has much to learn from business and the voluntary sector.

Registered charity no: 1096300.

Trustees
Karan Bilimoria, Alexander Downer, Andrew Feldman, David Harding, Patricia Hodgson, Greta Jones, Andrew Law, Charlotte Metcalf, David Ord, Daniel Posen, Andrew Roberts, William Salomon, Simon Wolfson, Nigel Wright.

About the Authors

Christopher Mahon is a UK fund manager specialising in the pension sector with over 25 years experience. He has worked across both UK defined contribution & defined benefit schemes as well as in the Australian superannuation system. He holds an MA (Cantab) from Cambridge University and is a Chartered Financial Analyst (CFA).

James Vitali is Head of Political Economy at Policy Exchange and leads on the organisation's economic and regulatory reform research. He joined the team in 2022 after completing a PhD in Politics at Cambridge University. During his time at Policy Exchange, James has authored a number of influential reports on housing, economics and regulatory reform. The Property Owning Democracy, released in December 2023, won support from across Parliament, including from four serving or former cabinet ministers.

Acknowledgements

Special thanks go to Sarah Luheshi and Daniela Silcock of the Pension Policy Institute for our early conversations, encouragement and goodwill.

All opinions and errors contained herein remain the authors'.

© Policy Exchange 2024

Published by
Policy Exchange, 1 Old Queen Street, Westminster, London SW1H 9JA

www.policyexchange.org.uk

ISBN: 978-1-917201-13-1

Contents

Foreword 4

Executive Summary 6

Recommendations 8

Introduction 9

Context 11

The UK's defined contribution system is reaching an inflection point 11

Why Australian Superannuation is relevant and how the system came about 14

How the UK and Australian Regulators Differ: Outcomes as a priority 16

Defining success: How Australian policymakers place a greater emphasis on retirement outcomes 16

Contestability and Competitive pressure: How superannuation encourages competition & performance in ways the UK does not 19

Differing attitudes to retirement risk 21

Performance: How UK savers structurally underperform 24

UK Pension schemes have underperformed Australian 24

Costs – The UK has successfully delivered a very low cost pension system. But is the focus on costs delivering better outcomes? 27

Is the focus on fees helping deliver better outcomes? 28

Other lessons from Australia: Contribution rates, advice, and tackling inflation 29

Different models for advice 32

Innovation in the annuity space 32

Conclusions 34

Expanded detail on our recommendations 34

Foreword

Baroness Altmann CBE, Former Minister of State for Pensions

UK pension assets amount to over £3 trillion, making the UK the largest market in Europe and third largest in the world. These assets are a vast potential national resource for long-term investment in this country and could provide vital capital to fuel future economic growth.

UK pensions used to hold significant sums in domestic investments, both equities and fixed income. Sadly, over recent years, that natural source of long-term domestic support for our markets and corporate sector has evaporated. Meanwhile, large swathes of our economy require urgent new investment. Well-intentioned regulatory restrictions have driven pension assets to move away from higher-return investments such as equities or real estate in general and from UK investments in particular, as low-cost, global passive mandates have increased exponentially.

Growing Capital, the latest in a series of influential Policy Exchange contributions to the debate on reforming the UK pensions sector, discusses some important lessons to be learned from international best practice. It offers interesting ideas for improving expected UK pension fund returns, particularly as defined contribution schemes come to dominate a growing proportion of the market.

In this paper, the authors specifically consider possible learnings from Australia. Its superannuation system is often cited as a model of excellence in pension policy, with compulsory contributions and large-scale schemes. Of course, many aspects of the Australian system are very different from the UK framework, but there can still be potential to draw lessons selectively from its successes.

The paper suggests the Australian pensions market is more competitive, delivers better returns for retirees, and is more user friendly for members. Information is more readily available to assist with making better investment decisions and there is no need to navigate the complicated system of tax reliefs we have in Britain.

I would offer one further thought to consider, which is the extent to which our pensions funds support domestic investment. The UK's regulatory framework, favouring international diversification, low charges and risk-aversion, has fostered drastically reduced allocations to UK markets, stripping them of their once-strong domestic investor base.

Average UK pension fund allocation to domestic equities is around 3%, after large-scale selling in recent years. This leaves corporate UK, financial markets, long-term investment in infrastructure, housing or smaller and medium firms, without the support of pension inflows they used to enjoy.

Australian pension funds have a much greater weighting – 37.7% - in Australian companies, thus providing greater support for its domestic firms. Indeed, UK pension funds are international outliers on this score. Canada, Germany, Japan, Singapore, France, Italy, Sweden and the US all have significant portions of their assets in domestic equities, far outstripping their global index weighting.

This paper is justifiably concerned, as its title suggests, with growing pension capital. But we must also consider how UK pension funds can provide a more reliable funding model for domestic, long-term growth.

I have always sought to champion the interests of pensioners who have worked hard through their lives and deserve dignity and prosperity in retirement. In that cause, we should consider good ideas and policies, wherever they might come from. Australia offers several.

Executive Summary

The past 18 months have seen proposals for pensions reforms springing up as never before. As so often, Policy Exchange has led the way. In November 2022 *Policy Exchange* published *Unleashing Capital* - in part proposing more growth capital in pensions. The Government listened and already a number of our proposals have become official policy with the *Mansion House reforms*, which seek to get more pension assets into unlisted holdings to help boost economic growth and investment returns.[1]

This report develops our proposals further. It aims to move beyond investment questions and focuses on the pension saver, asking whether the pension regulations themselves are delivering the best outcomes for growing the capital of savers and retirees alike. The truth, broadly speaking, is that they are not.

The existing UK approach to pensions regulations can be traced to an era when defined benefit dominated and when the defined contribution system was relatively small. Now the tables have turned. Defined contribution schemes are now the dominant vehicle for the current generation of pension savers comprising 26% of all pension assets. Growing fast, by the end of the decade, their assets will overtake defined benefit schemes.[2]

Existing regulatory approaches have prioritised concepts such as safety and value for money that were crucial for those legacy defined benefit schemes, but the same approach gives little emphasis on the outcomes that matter more for defined contribution members.

Well intentioned concepts such as 'value for money' perhaps still made sense in 2012 when autoenrollment was introduced and pension costs were higher. Now, having successfully reduced costs these same concepts are allowing a system to flourish where certain risk profiles are too low, private market exposure too low, performance too low with low levels of contestability.

The results? Firstly, a lack of transparency in what should be a highly contestable market. Secondly, regulations that force overly defensive allocations onto preretirement savers. And thirdly and most importantly, while there remains an understandable focus on costs, there is far too little attention paid by regulators to the end objective of securing the best retirement income for savers.

1. Links to reports Policy Exchange Unleashing Capital: Link

   Tony Blair Institute Investing in the Future Link

   Pension and Lifetime Saving Association: Policy position on pensions and growth Link

   Mansion House 2023 Link
2. Thinking Ahead Institute, Global Pension Assets Survey, 2024.

This paper will show how these issues can be traced to the legacy of regulatory objectives defined and prescribed in an era when protecting against a Robert Maxwell style failure was the emphasis. But the pension world has changed. Defined benefit has shifted towards defined contribution. Autoenrollment and pension freedom has been introduced. Mansion House reforms are on their way.

We need a new approach to the regulation of the pensions market that reflects these new realities. We need a shift in emphasis away from focusing on costs and safety, and towards outcomes and better investment returns for savers. The prize on offer is a boost in the average pre-retirement savings pot - potentially to the tune of £12,000.

Learning from Australia

The world of UK pensions is changing. With every step that is taken, the UK is coming closer to building an Australian style superannuation system. Widely celebrated, the Australian superannuation system in many ways represents the future of UK defined contribution schemes. But until now there has been little examination of whether UK regulatory priorities could allow that success to be emulated here.

This report details to what extent current UK policy frameworks have created stumbling blocks to replicating the success observed in Australia. It argues the UK has much to learn from the Australian regulatory focus on outcomes. The regulations behind their famous superannuation system have a more proportionate approach to risk, better entrench competition, and delivers better overall outcomes for savers.

While the recent King's Speech contains certain recommendations to make some limited changes to the value for money framework, the current proposals still are rooted in the traditional 'value for money' concepts that have held back the market from delivering Australia style returns in the UK. Issues around risk profiling, transparency, competition, and performance will likely remain.

Ultimately the case advanced is that as UK defined contribution schemes become ever more the focus, it is time to shift gear on regulatory priorities. It is time to focus on growing capital. And this paper looks down under for how this might be done.

Recommendations

Our recommendations are informed by best practice from Australia and can be readily introduced into the UK pensions environment. As a package, they are designed to deliver a regulatory framework that is more outcome-focused, better promotes competition and contestability in the market, and is adapted to future challenges around savings and retirement. A fuller discussion of our recommendations can be found on page 34.

1. **Introduce a new high level objective of "seeking to promote best retirement outcomes" for regulatory bodies including The Pensions Regulator and the FCA.** Existing objectives such as "value for money" and "security" ought to be downgraded to supplementary objectives, with an additional new supplementary objective of "supporting financial best interest".

2. **The Pension Regulator should launch and maintain a centralised portal of DC pension fund performance.** The initial focus would be on DC Master Trusts, but with a view to extending coverage to the defaults offered within large group personal pensions. This will increase, transparency, contestability, and will give consumers a better opportunity to compare investment decisions being made on their behalf.

3. **The Pension Regulator should review and reverse the regulatory preference for derisking strategies and 'lifestyling'.** This has led to poor outcomes, particularly for older savers close to retirement. As an alternative, the regulators should consider ways to boost innovation in the annuity market, for instance by changing rules - as Australia has done - to allow innovative retirement income products such as investment linked annuities to flourish.

4. **Savers need to save more. We propose increasing the overall autoenrollment minimum contribution rates by 0.5% per annum for 4 years, to raise the overall contribution rate from 8% to 10%.** This higher contribution rate will be better able to sustain living standards in retirement, and is closer to the Australian contribution rates of 12%. Such a change is also likely to help break the inflationary wage spiral the UK has recently been fighting, without negatively impacting total employee compensation.

Introduction

UK pension regulations were drawn up in an era when *defined benefit* dominated and certain scandals were fresh in the mind.

Pension regulators never forgot the saga of the Robert Maxwell and the missing £450m from the Mirror Group pensions. And they have always been kept on their toes by the risks to such defined benefit schemes. Just think about the 2021 collapse of Phillip Green's Arcadia group with a £510m pension deficit[3] – ultimately requiring a regulatory approved deal.

Such front page stories have made UK regulators understandably jittery. Safety is paramount: de-risking schemes a regulatory priority; optimising investment returns less so. In any case in the DB world outcomes are largely fixed with the employer guaranteeing the ultimate pension payments.

This safety first mindset has carried over into the defined contribution world. But DC pensions have very different mechanisms. Outcomes are variable. With no guarantee from a corporate sponsor, investment performance matters far more. Yet focusing on outcomes and creating conditions to help grow pensions pots has not been made a high level UK regulatory objective.

Not all regulators are created equal

By contrast, the Australian Prudential Regulation Authority (APRA) which looks after superannuation schemes did not come from a DB background. It focuses on a very different set of objectives. APRA publicly disavows a 'safety at all cost' attitude, places a much greater emphasis on performance outcomes and has a wider brief including increasing competition.

It should be no surprise that each country's DC pension system has largely responded as directed by the incentives generated by the regulatory framework.

The UK's regulators focus on cost, value & reducing risk. All laudable. But the industry gives on average lower investment returns (especially so for older workers, due to a regulatory preference for derisking). Contestability and transparency are poor with pension savers having limited ability to change provider.

3. Guardian Report Link

The Australian system is outcome focused. Pensions there deliver substantially better returns particularly for older savers. There are much higher levels of transparency. Performance competition is intense. League tables of investment returns abound and moving provider comes easily. But the greater level of performance comes with slightly higher costs.

Regulatory priorities need to adapt

This paper contends the DC pension world needs a focus on outcomes. In the short term, without this and despite the Mansion House reforms, the UK will lag in the deployment of unlisted asset classes that can support growth.

In the longer term, a shift to an outcome focused policy regime will help in a myriad of ways. In Australia this approach has led to greater investment success, better retirement outcomes and more capital for economic investment. Success breeds success and in Australia has led to a higher engagement – individually, regulatorily, and ultimately politically. The opportunity is to build a similar virtuous circle for the UK DC pension world.

Context

The UK's defined contribution system is reaching an inflection point

In the UK, the slow handover from defined benefit (DB) to defined contribution (DC) schemes is happening, and likely to accelerate. Indeed, the majority of DB schemes are now closed.[4] DC schemes are ever more the future.

Private sector DC contributions are already more than double the amount going into private sector DB schemes. By 2030, DC assets will have grown from £600 billion today to overtake the 1.5bn in DB[5].

And within the DC world, things are changing. Autoenrollment was introduced in 2012. Pension freedoms of 2015 ended the compulsory purchase of annuities. The Mansion House reforms of 2023 aim to increase the amount of unlisted growth capital involved in the pension system.

Regulators have focused ever more on costs

The introduction of automatic enrolment system (AE) in 2012 was a catalyst for regulatory change. AE had lower earners in mind where arguably costs could have a disproportionate impact. Reducing fees became a key regulatory motivation.

On the face of it, a focus on costs may make sense. But this report will show how in practice, too much focus on this one metric has created worse outcomes for pensioners. And the in world of pension regulations there is a long history of laudable intentions backfiring (see box). As this report will show, other issues matter too (risk profiles, private market exposure, transparency and contestability), all of which contribute to success. So far, there is little appetite to widen scope to address these issues.

Let's make outcome the priority.

Despite the worse outcomes in the UK, there is little political challenge to the current arrangements. It is notable how the UK state pension and the 'triple lock' remain the spotlight of the political pensions debate and how little attention is paid to the investment performance of UK pension funds.

Regulators are somewhat aware of this, but change is slow, and the limitations of the current approach have started to be acknowledged. Certain reforms are underway for the Value for Money Framework.

4. PPF data shows a 145% funding ratio Link
5. Data from Schroders Link and Pension Policy Institute, DC future Book 2023 Link

But any revisions to the framework are unlikely to address the wider issue that value for money alone is not the ultimate objective, and is merely one element of securing best retirement outcomes.

Good intentions going awry

The limitations of well intentioned principles – such as "value for money" - take up much of the discussion in this report. Of course, unintended consequences are not limited to the DC market. 20 years ago, the Accounting Standards Board (ASB) instituted a new set of accounting rules (FRS 17) that caused a substantial shift in how DB pension schemes were accounted for in the UK.

The introduction of these rules seemed well-intentioned and reasonable enough. The idea was to introduce more transparency and objectivity into the costings of pensions, but in practice the result was to encourage many schemes to close.

Under the previous regime – "SSAP 24" – employers had been allowed to use a "systematic and rational basis" to recognise pensions scheme costs. Importantly, variations from the regular cost were "allocated over the expected remaining service lives of the current employees".[6]

The old rules meant actuaries were allowed to plug in the higher expected returns from equity investments far into the future, and to spread those returns out over time, somewhat smoothing out stock market volatility. But such actuarial assumptions can be subjective. After the profound bear market of 2000-2003 (during which equities markets fell 50%), corporate scandals like Enron, and the collapse of Equitable Life (in which overly optimistic actuarial assumptions played their part) there was little appetite for opinions - even from actuaries.

The new FRS 17 reporting standards rejected such smoothing approaches and sought to achieve greater objectivity by requiring that volatile investment gains and losses be immediately recognised in a scheme's valuation. And the cost of providing pension promises to scheme members long into the future would be discounted by (also volatile) market interest rates.

The interaction of these two changes led to large and unpredictable swings in valuations, with serious impacts for a sponsoring company's ability to budget effectively. The hazards of operating after the introduction of the FRS 17 were in some cases crippling. Often used to illustrate the impact was the case of British Airways (now IAG group). In 2006, BA's market capitalisation of £4 billion was dwarfed by pension liabilities of £12 billion leading to BA being described as 'a giant pension fund with an airline attached'.[7]

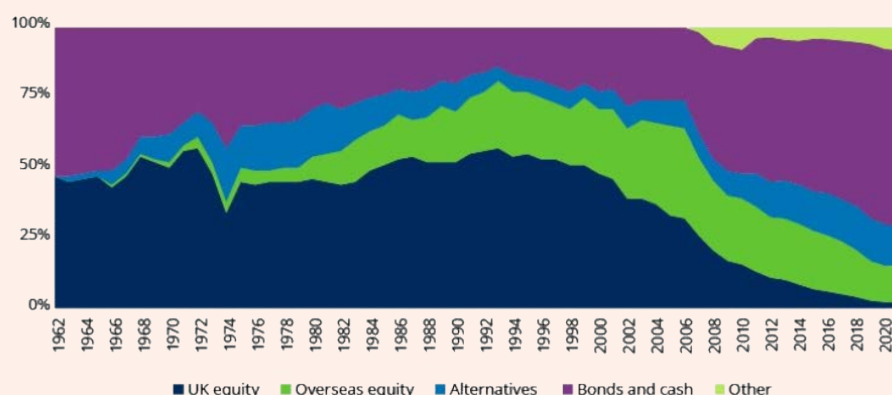
Combined with the abolition of dividend tax credits - at a compounding cost to schemes of £5bn per year - many sponsoring companies simply decided DB schemes weren't worth the risk. In 2006, 43% of DB schemes were still open to new members. Five

6. Financial Reporting Council, "Superseded Accounting Standards – SSAP 24", Link
7. See news report Link

years later it was 16%. Today it is just 9%[8]. Less generous but easier to budget DC schemes have taken their place.

Beyond closures, for the remaining schemes the effect of FRS17 was to encourage derisking – switching out of equities into bonds. In 2002, schemes held over 60% in equities on average. By 2023 these schemes held less than 9% in equities[9], and have little interest in other high return asset classes such as private equity, infrastructure, venture capital. It is not just bad news that the schemes have missed out on years of gains from such holdings; it is also bad for the wider economy, with many UK businesses going capital hungry.[10]

The evolution of the UK defined benefit pension fund allocations[11]



What transpired to be a hugely significant regulatory reform suffered from little democratic oversight. While the changes did involve numerous consultations, ultimately the new rules were agreed by a vote of the ASB board – without a mandate to consider the wider implications for pensions provision.

Happily, by virtue of two decades of substantial stock market growth, generous company contributions, and the return of interest rates to normal levels, the average DB scheme now boasts a funding ratio over 140%[12]. Even latest indications from IAG also hint at a surplus[13]. However the changes created unnecessary pain and costs along the way, especially for the sponsoring companies, and encouraged the withdrawal of these most generous types pf pension schemes.

Belatedly, it is starting to be acknowledged that the pendulum swung too far. Government consultations are underway to support certain changes for DB schemes that aim to free up a small sliver of the current large surpluses to participate in and benefit from economic growth. Yet even the most optimistic outcome still won't be enough to change the big picture of closures and derisking.[14]

With many DB schemes now largely a legacy offering, and the pensions world becoming increasingly DC centric, it is the effects of our present regulatory framework on the DC world that will be the focus of this paper.

8. PPF Purple Book Link
9. LCP link
10. See Policy Exchange, The Property Owning Democracy (2023); The Resolution Foundation, Ending Stagnation: A New Economic Strategy for Britain (2023)
11. Schroders Link
12. Aggregate funding position for DB schemes reported at 147% in December 2023 Link
13. Scheme financial statements Link
14. For an example, see the LCP proposal Link

Why Australian Superannuation is relevant and how the system came about

Each change the UK has made has brought it closer to the Australian superannuation system. The Australian model is an example of a mature DC system, where superannuation funds (loosely equivalent to UK DC master trusts) underpin Australia's success. Their system is widely celebrated and globally renowned. It is able to payout some of the highest benefits to retirees around the world[15].

The pension market in Australia evolved very differently, and avoided the defined benefit funds seen in the UK. Intriguingly the context for the birth of superannuation was a desire to avoid an inflationary pay spiral. 1983 was a time of high inflation, and the trade unions agreed to forgo a 3% pay increase, and instead placed this into a new superannuation system.

This link with trade unions remains. Even today, many of the biggest schemes are affiliated with trade unions, or particular sectors or geographies. These have become known as industry funds, and financially are structured similar to UK mutuals i.e. run on a "profits-for members" basis rather than on an entirely commercial approach. Prominent examples include Australian Super, Australian Retirement Trust, Care Super, and Rest Super. While other "for profit" types of super funds do exist, the "for profit" sector is a smaller, shrinking share of the market and less well known internationally. The better known industry funds remain the bedrock of the Australian system and given their international reputation and relevance are the focus of this report.

Australia's political focus

Outside of superannuation, Australia's equivalent of the UK state pension is means tested. This difference reinforces the importance of super to many Australian households. Today in Australia, the superannuation industry is considered a national gem and attracts high level of political support and public engagement. "Super" is front page news.

Contribution rates have been steadily increasing. From the original level of 3% of total earnings in 1983, compulsory contributions are planned to reach 12% in 2025. Obligatory employee contributions were cancelled by the incoming Howard government in 1996, making the whole superannuation concept extremely popular. Since then, employer contributions have been the focus.

Recently, reforms introduced in 2021 under the banner of "Your future, Your Super" require the regulator to conduct performance tests on schemes and close underperforming funds. This is a step change in regulatory involvement and is a huge focus for the industry currently.

15. Pension Policy Institute, International DC Comparison Link

Timeline of Superannuation Policy in Australia[16]	
1970's	Superannuation is not transferable between employers and limited to public servants, with coverage at less than 30% of employed persons
1980's	Widespread expansion of superannuation Superannuation guarantee introduced: minimum employer contributions for most employees Trade unions agree to forgo a national 3% pay increase which would be put into the expanded superannuation system to help combat inflation
1992	Employer contributions begin to increase from 3% to 9% by 2002
1993	The World Bank considers the Australian pension system, based on compulsory superannuation, the age pension and voluntary savings, as 'world best practice'
1990's	Employee contributions scrapped; employer contributions become the focus
2004	Regulations changed to allow portability between superannuation accounts, later built on by the "superstream" project - an industry wide effort to ease switching
2007-10	Impact of the GFC: Assets fall from a high of $1.2 trn in 2007 to under $1trn in 2009. Losses are recovered by June 2010
2011- 2014	MySuper reforms – default options encouraged to be simple lower cost funds with stronger performance
2015- 2020	Consolidation in the industry continues. The number of superannuation funds decreases from 255 in 2015 to 150 in 2022
2020	Stapling introduced: designed to encourage every Australian to hold only one (portable) superannuation account rather than multiple accounts
2021	Your Future Your Super reforms: APRA implements performance tests to close or consolidate underperforming funds, with surveys expecting less than 50 funds to ultimately survive[17]

16. Parliament of Australia, official superannuation chronology link and Policy Exchange Unleashing Capital
17. JPMorgan survey reported by Investment Magazine see link

How the UK and Australian Regulators Differ: Outcomes as a priority

Defining success: How Australian policymakers place a greater emphasis on retirement outcomes

Regulatory objectives on a topic like pensions can vary considerably from country to country. The specificities of each regulatory framework in turn have a considerable bearing on how markets operate and perform.

The table below shows how UK regulators put emphasis on safety, security, and reducing costs (via the value for money framework).

By contrast, the Australian regulator publicly disavows a 'safety at all cost' attitude, places a much greater emphasis on outcomes such as investment performance and retirement incomes, and has a wider brief to include increasing contestability and competition.

In their own words: Demonstrating the different priorities. (Selected statements from the regulators. Author's emphasis)

UK regulators focus on s ecurity & value…	…whereas Australia embraces outcomes
"Our priorities: 1) Security: Savers' money is secure 2) Value for money: Savers get good value for their money 3) Scrutiny of decision-making: Decisions made on behalf of savers are in their best interests 4) Embracing innovation: The market innovates to meet savers' needs 5) Bold and effective regulation: TPR is a bold and effective regulator"	"APRA seeks to ensure that a superannuation fund manages contributions […] in members' best interests to generate retirement income" [considerations include:] "efficiency, competition, contestability and competitive neutrality" "Risks to these outcomes may be financial (e.g. risks of poor investment returns), operational (e.g. a failure of a computer system) or behavioural (e.g. risks relating to governance, culture and remuneration)" "APRA is not tasked to pursue a 'safety at all costs' agenda"
Source: thepensionsregulator.gov.uk[18]	Source: www.apra.gov.au[19]

18. Taken from "Our Priorities" section at The Pension Regulator Link
19. Taken from "Objectives" section at Australian Prudential Regulation Authority Link

Of the five priorities for the TPR, not one directly speaks to performance outcomes. The closest match is value for money, where good outcomes are implied rather than directly mentioned. But as we shall see, value for money rewards a low cost system but one where certain risk profiles are too low, private market exposure too low, performance too low with low levels of contestability.

By contrast APRA ranks poor investment performance as the number one risk to outcomes.

The UK's lack of focus on DC performance outcomes and its risk aversion is longstanding. This can be seen for example as far back 2012/13, with the TPR annual report for that time highlighting four strategic themes:[20]

TPR Strategic Themes (2012)

- Theme 1: Reducing risks to DB scheme members
- Theme 2: Reducing risks to DC scheme members
- Theme 3: Automatic enrolment
- Theme 4: Better regulation

The identical wording of the first two items highlights both the desire to treat DB and DC schemes alike and the risk aversion of the regulator. But for DC reducing risk often means reducing returns. Yes, since then efforts have been made to focus more on outcomes (including recent planned changes to VFM), but this report argues, bigger shifts in approach are needed. Outcomes are still not explicitly listed as a priority.

Note these priorities and strategic themes are not those enshrined in legislation. The objectives laid down in legislation are generally more opaque. Examples of legislative objectives – in the case of the TPR laid down in the Pensions Act 2004, amended by the Pensions Acts 2008 and 2014 - include "To protect the benefits of members of occupational pension schemes", or "To promote and to improve understanding of the good administration of work-based pension schemes". In other words, the TPR priorities are self-chosen and can be changed without primary legislation.[21]

Does it matter?

Does it really matter how priorities for regulators are phrased? While there is no perfect approach, we give three brief examples to highlight the impact. We expand further on these in the report.

Example 1: Differing attitudes to performance

In the UK it is very hard to access league tables of DC pension fund performance. Consumers struggle to know if their pension pot is performing as well as peers. In Australia, the regulator publishes the league tables themselves[22] which are inspected with great intensity by both the Australian media and the investment industry[23]. The regulator itself gets involved and closes underperforming schemes. Clearly, the Australian approach has led to different levels of performance focus and transparency.

20. TPR annual accounts taken from National Archives Link
21. TPR statutory objectives seen in the TPR annual accounts, page 6, Link
22. See APRA announcing it is shutting down certain poorly performing super funds Link
23. Example Australian media scrutiny "Best and worst super funds revealed" Link or Link

Example 2: Differing attitudes to retirement risk
The risk averse nature of the UK regulatory priorities have forced UK pension funds to adopt derisking strategies known as lifestyling as the default option for savers near retirement. Such strategies have had a significant drag on investment returns, and despite their promise have failed to protect savers during recent market volatility. By contrast, such strategies are less embraced in Australia, with better results.

Example 3: thinking along the whole value chain leading to retirement income
Australian policymakers were quicker to get involved to tackle longstanding low and unappealing annuity rates. Regulators innovated and introduced new rules to encourage innovative retirement income stream products including annuities offering payment that could grow, but without guarantees[24]. In Australia, the wider prioritisation of outcomes such as retirement income more easily allows this type of lateral thinking from regulators. By contrast, such innovation has been hard to find in the UK.

Examples of Differing Approaches to Outcomes

	UK Auto-enrolment	Australia Superannuation	Comment
Official performance rankings	No	Yes	Australia: Official statistics published quarterly including performance covering all superannuation funds. Underperforming schemes closed down via an annual performance test. Preretirement derisking strategies are in general not the default. Outcomes in other parts of the value chain also monitored. For example, creative solutions to low annuity rates were encouraged with specific legislation, fostering certain variable annuity products that could offer more attractive rates (see example). UK: No central portal for performance comparisons exists. Preretirement derisking into cash/ bonds universally adopted as the default - with dubious results. Little attention paid to other parts of the value chain, such as fostering innovation in the annuity market.
Staying invested in the build up to retirement	No	Yes	
Wide definition of outcomes (E.g. Responding to low annuity rates)	No	Yes	

24. See Australian legislation Link which triggered the creation of certain variable annuity products, while the UK made no changes

Beyond the regulations, the emphasis on financial performance extends to pension scheme trustees. For example, Australian super fund trustees have a strict duty to act in members' "best financial interests" allowing a laser-like focus on investment performance.

For UK trustees it is usually "best interests", i.e. without the "financial" – allowing a more subjective assessment (at times more stakeholder friendly), less driven by results[25].

No system is perfect. Some critiques argue the focus on outcomes in Australia has been taken too far[26]. Specifically, the annual performance test used in Australia which defines whether superannuation schemes are forced to close is flagged by some as being inflexible and rigid. And a fear of failing the performance test, critics argue, may also encourage herdlike investment approaches. Time will tell if these fears are well founded. In the meantime, the UK is a world away from these worries. This report's recommendations can be introduced without fear of "going too far" and do not undermine the case for shifting the UK closer to the Australian model.

Contestability and Competitive pressure: How superannuation encourages competition & performance in ways the UK does not

> *"Competition is vital to a healthy financial system [...] and generates better consumer outcomes through greater choice and lower price"*[27]
>
> ARPA

APRA has a wider mandate than its equivalents in the UK, especially the TPR. APRA's mandate includes fostering a competitive and contestable market. This difference in regulatory focus comes through in their domestic pension environments.

Ultimately in the UK, competitive performance pressures are weak. League tables of performance, fees, or allocations are not readily accessible to savers (there are some league tables, including those used in this report, but such data is difficult to access and often out of date, and tends to be aimed at the industry insiders rather than savers). In any case, generally speaking, the choice of provider is a choice the employer makes, which can be difficult for the saver to change. The regulator's website itself is a good illustration of the lack of information transparency in choosing a pension provider. Starting at "Step 1: Choose a pension scheme" and following the links, it is difficult to find or compare performance, investment allocations or even costs for many DC master trusts offering their services (with a few notable exceptions). What information can be found is often fragmented across multiple documents (such as factsheets, KIIDS documents, prospectuses etc). Media interest is correspondingly sparse.

In Australia, moving providers is actively encouraged. League tables of performance are a regular staple. Adverts constantly invite savers to switch. Comparisons are facilitated by centralised portals for data such as performance or costs, with timely data updates. Changing providers is relatively painless, partly as a result of the substantial investment in

25. See Financial Times discussion here
26. See example critiques here & here and some suggestions on improving the testing regime here
27. ARPA

building the "Superstream" collective infrastructure across the industry. Product Disclosure Statements are required for all schemes, which are easy to find concise details of each superannuations fund's key terms including targets, fees, and asset allocation. While the situation will improve in the UK after the revised value-for-money (VFM) framework is introduced (expected late 2025 and included in the recent King's Speech), those new rules are still being refined. For instance, while it is likely the performance reporting will become standardised, it is not certain performance reporting will become centralised. Transparency over peer group performance, fees, or allocations may still remain less than in Australia.

Examples of Differing Levels of Contestability

	UK Auto-enrolment	Australia Superannuation	Comment
Ability to compare providers (e.g. fees, allocations, performance)	No	Yes	Transparency requirements Australia: The regulator collects and publishes performance data which are supplemented by open source industry rankings. All super schemes publish a product disclosure statement which must include details such as strategic asset allocation, fees and the investment time period UK: Providers are harder to compare. A small employer choosing a pension scheme on the official website would find it difficult to compare providers. Fees, performance or asset allocations are often absent or hard to find (save for a few notable exceptions) on the provider's own websites. Information is fragmented across documents. Media coverage on these attributes is correspondingly sparse. Existing VFM rules are being expanded upon to help with these issues with revised rules are being drawn up.
Ability to change provider	Partial	Yes	Changing providers Australia, whilst the employer is important and sets the defaults, individuals can easily change providers. UK: Contestability tend to be lower, and changing providers tends to be more problematic. For example, consolidating pension pots is easier for older pots than current and in some cases (e.g. small balances) may not be advisable

While certain elements of the Australian market could be introduced relatively painlessly (e.g. publication of official performance data or the introduction of product disclosure statements) other elements would come at a cost.

For instance, the infrastructure behind superannuation that allows easy switching between schemes was an industry wide effort built at a high price. Called Superstream, it was a framework to allow money and information to be transferred between the employers, superannuation funds, service providers and the Australian Taxation Office (ATO). It is estimated to have cost A$467m (~£250m) and took 7 years[28]. Such a system might not necessarily be appropriate for the UK context.

Differing attitudes to retirement risk

UK regulations enforce a more defensive "lifestyle" approach to retirement risk, despite weak evidence for the theory

The UK regulatory priorities of ensuring safety and risk reduction are very much in evidence when it comes to the default approaches in planning for retirement. The specific regulatory priorities have shifted the UK into one very particular corner of retirement planning. The default retirement planning for UK pension funds is based around a concept called "lifestyling". There is nearly 100% adoption of this strategy, because it is the regulator's accepted approach.

Lifestyling is an investment strategy that shifts savers out of equities into supposedly safe bonds as savers get close to retirement. Lifestyling is based on the theory that bonds can be used to create 'lower risk' portfolios. The process tends to be mechanical, based around age. Little adjustment is made for the market context.

However, in truth it was always moot if the theory would work. Many questioned whether a default approach of mechanically increasing bond exposure really lowered risk, especially during the zero interest rate years when bond prices were especially high and bond yields especially unattractive and low.

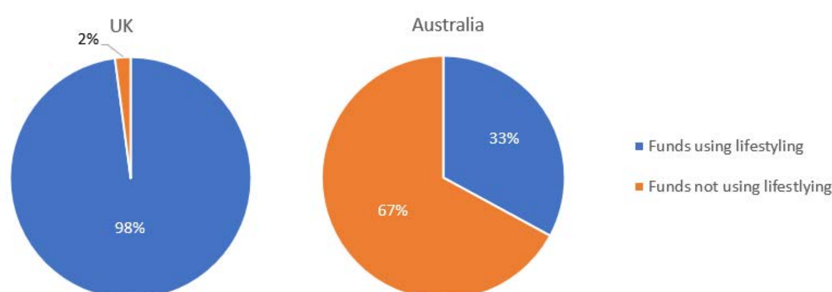
Nevertheless, lifestyling is the clear priority of the UK regulator, and so has been comprehensively adopted by providers.

28. Official costs for SuperStream are reported here.

The UK approach is not universally accepted

But globally the lifestyling approach is far from universally accepted. For example, the same retirement planning challenges exist in Australia. If it was universally accepted that higher bond exposures make sense as retirement approaches, the lifestyling approach would just as prevalent in Australia. In fact, the take up of lifestyling is much lower, at around 30%.

Regulations mean a near universal adoption of lifestyling in the UK – in contrast to Australia (Proportion of schemes using lifestyling as the default investment approach).[29]



In other words, it is the regulatory preference, rather than any intrinsic value in the investment theory itself that has driven the UK to be such a stickler for lifestyling, with a near 100% adoption. In Australia lifestyling is considered just another competing investment approach, one of many. It is not enforced.

The results from lifestyling are not good. Recent press coverage has highlighted the devastating financial impact some savers experienced from this theory going awry, with pension pot falls of 20-30% not unheard of. We examine the results more broadly in section 4, but some of the press headlines give a flavour[30]:

- "Why those retiring face 'massive' losses despite FTSE highs?" Guardian
- "Lifestyling: a hidden danger lurking in your pension pot" Financial Times
- "IFAs blast lifestyling as lifestealing" Professional Advisor
- " Lifestyle funds are from a bygone era" Professional Advisor

29. Australian data from APRA research Link, table 1. UK data average of Corporate Advisor Master Trust data Link and Pension Policy Institute, DC future Book data Link
30. Press reports: Guardian Link; Financial Times Link; Professional Advisor Link, Link

The UK could have changed course after pension freedom

The rationale for the forced adoption of lifestyling in the UK used to be based around the compulsory purchase of an annuity. Annuities are a fixed income type of offering, and so having more bond-like fixed income exposure in the glidepath to an annuity purchase had some logic. But the pension freedoms of 2015 ended that requirement. Annuity sales fell 90% from around 500,000 in 2009 to around 50,000 in 2022[31], killed by a combination of pension freedom and increasingly unattractive annuity rates. Many argued lifestyling based on the glidepath-to-annuity logic approach looked like something from a bygone era and increasingly misplaced.

Certainly, after the introduction of pension freedom, UK regulators could have steered away from lifestyling. Annuities were no longer mandatory, removing one of the main rationales for the approach. But the UK did not change course.

Instead, the FCA doubled down and pushed providers to enhance and refine their lifestage profiles, for example under rule CP15/30[32]. Tellingly, the FCA did not ask if in the zero interest rate environment putting ever more into low yielding fixed income was wise, or appropriate given few retirees would actually go out and buy annuities. Instead, the FCA announced it was "pleased to note the lifestyle glidepaths"[33]. Remarkably, lifestyling still remains the default accepted policy even though in practice this has produced poor outcomes for pensioners, as we will show in more detail in section 4.

The UK is not focusing on outcomes

So why have UK regulators enforced a very different approach to retirement planning to their Australian counterparts?

The attraction for the authorities stemmed from a theory that appeared to be tailor made for a safety conscious regulator. Theoretically, lifestyling aims to give lower, safer, more predictable outcomes. That married well to the UK regulatory objectives such as the strategic theme of 'reducing risk in DC pensions' that the TPR wrote about in 2012.

The theory was ideal for what the regulator had tasked itself to look for, and with the overriding focus being on value for money (i.e. driving down costs) the authorities had little bandwidth to ask further questions or inspect the claims with a more sceptical mind. It is an example of an unintended consequence of having priorities other than securing the best retirement outcomes for savers.

31. PPI DC future book Link
32. See FCA CP15/30 Discussion on Lifestyling, p64, in which the FCA pushed to further refine rather than scrap lifestyling Link
33. FCA lifestyling investment findings, 2017 Link

Comparing outcomes: Lower costs do not mean better performance

Performance: How UK savers structurally underperform

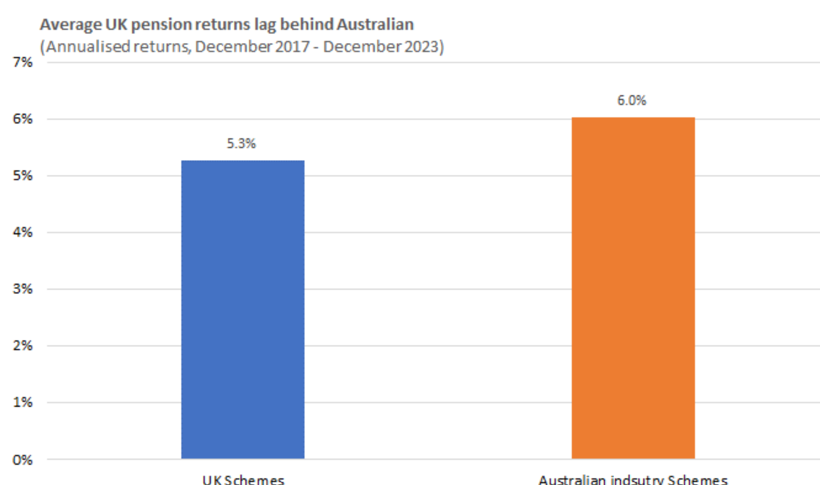
Few outcomes are as important in pensions as investment performance.

Comparing performance between two different countries in two currencies is tricky. Differing reporting standards and currencies make the comparisons imperfect, and as already observed UK performance data is fairly sparse. Nevertheless, broad observations can be made, which show UK savers underperforming.

UK Pension schemes have underperformed Australian

UK performance data starts with the Corporate Advisor Pension Average (CAPA) reporting performance figures for DC Master Trusts since 2018 (see footnote below). Overall figures are given only for certain age profiles, such as 30 years to retirement and 5 years to retirement. This report has recombined these cohorts to give an approximation for the whole industry on a similar weighting as seen in Australia.

For the period since data began being reported in the UK, the results suggest that UK has underperformed Australian, with UK schemes returning around 0.7% per year less (5.3% versus 6.0%).

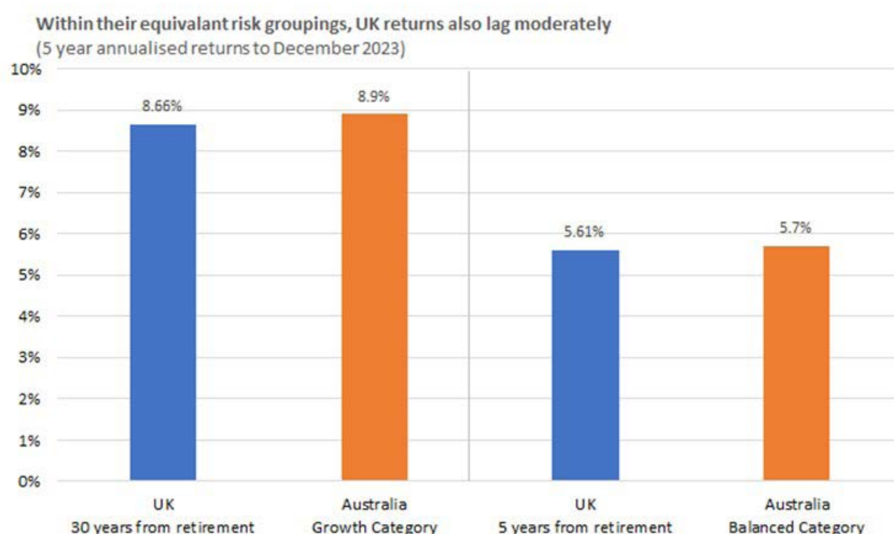


Sources: UK Corporate Advisor CAPA data in GBP, APRA data in AUD.[34]

34. CAPA data for DC master trusts is reported as gross before charges are deducted. APRA data for industry superannuation funds uses rate of return data, net earnings after tax. UK average is a 70:30 blend of the CAPA data for the 30 year pre retirement and 5 year pre retirement cohorts to give the approximate cohort weightings typically seen in Australia. The time period is the entire set of year end annual returns compounded since CAPA began reporting data in 2017-2018.

UK underperformance stems in part from mild underperformance within equivalent risk profiles

Adding to the evidence that UK schemes underperform is the observation that both individual age cohorts represented in the CAPA data underperform their equivalent risk category in Australia. This is the approach seen in other research that similarly finds the UK underperforms[35]. While this approach shows fairly slight performance gaps, the UK figures are gross of fees and costs while the Australian figures are reported net. In other words, the underlying picture could be less flattering for the UK.



Sources: UK data from Corporate Advisor in GBP, reported as gross before charges Australian data from SuperGuide.com in AUD, net of investment fees[36].

Setting aside the discrepancy from the impact of fees, the relatively small size of these performance gaps suggests it may be possible to get within touching distance by incorporating certain tweaks. Such evolutions may include ideas on the investment side (e.g. more private equity and venture capital), or introducing more performance pressure through league tables (discussed in section 3.1), or perhaps refocusing pension fund trustees on their duty to "financial best interest, rather than "best interest" more generally (discussed in section 3.1). All these could help close the performance gaps– but are only likely to be introduced if the regulator makes outcomes a top priority.

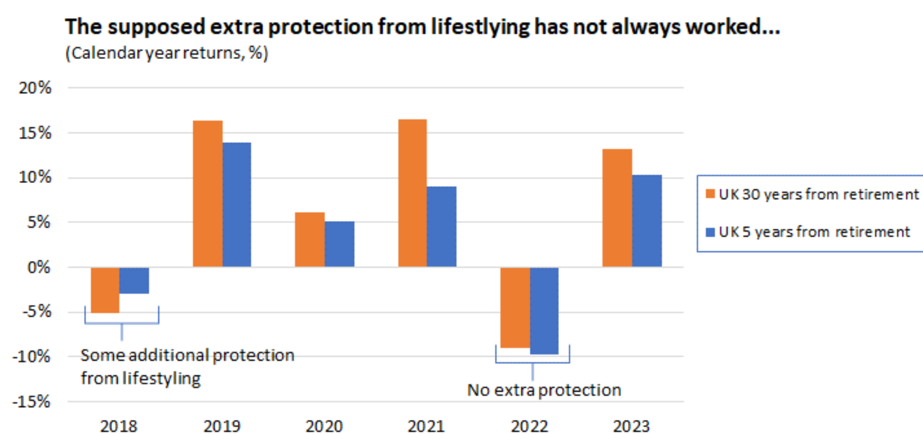
Arguably, however, the bigger story is that Australian schemes have fewer assets invested in the lower returning strategies – because lifestyling is optional and not the default approach.

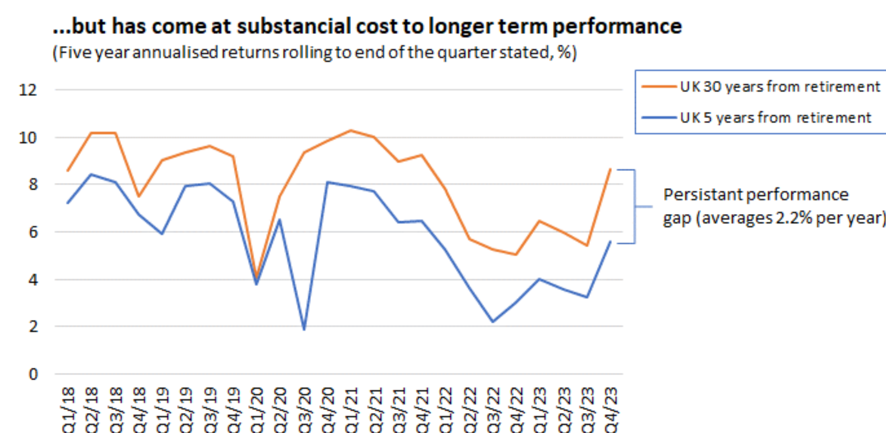
35. For example, see the Financial Times in depth report here comparing UK vs Australian approaches and returns
36. Nature of the source data means it is not possible to show the slightly longer term Dec 2017 – Dec 2023 time period used earlier; closest matching period has been used

The drag to performance that comes from lifestyling

Focusing on the performance figures solely from within the UK allows us to see the impact from the insistence on lifestyling in the UK system. This has meant there is a far greater weight in the UK system on the de-risked lower performance cohorts.

Such an approach could make sense if lifestyling protected savers during bad years. However it is not a given that derisking & lifestyling helps protect savers during market turmoil. Yes, lifestyling worked in 2018, but equally lifestyling failed to work in 2022 – both being bad years for markets. For this unreliable benefit, the performance drop for lifestyled funds is both quite marked and persistent.





Source: Corporate Advisor CAPA data

While these figures show the average performance hit from lifestyling, there is also the dispersion within individual outcomes to consider.

For example, the press reports highlighted in section 3.3 highlighted some of the individual stories. For all the theory that lifestyling was supposedly a low risk glidepath to retirement, falls of 20-30% were not unheard of in 2022 for certain providers of lifestyled approaches. Those affected were older savers approaching retirement - with the least working life left to financially recover. They saw a double penalty – low returns during the good years and worse returns during the bad years.

Calculating the impact of these proposals

The performance figures allow us to make some rough estimates of the impact the proposals in this report could have. For reasons of simplicity we focus on the potential gains from removing the performance gap for older savers. This mimics the Australian approach of making lifestyling optional, rather than the default.

If the pension pot performance of older British workers had matched their younger counterparts, their returns would be around 2% per year higher. This is shown in the above exhibit based on rolling five year returns for periods ending 2018 - 2023. Notably, this is a persistent and stable performance gap, appearing in the five year data both before and after the recent huge changes in interest rates. It is thus not driven just by one bad year, but a structural feature of the UK default pension strategy. A typical pre retirement pension pot is worth £107,000[37], and so UK savers typically been missing out on gains worth around £12,000 (based on five years impact).

Performance conclusions

It is clear the UK approach is not giving the best results. For older savers who have been lifestyled, the picture is stark. The picture may not be so poor for younger savers but still they are lagging the equivalent Australian.

This paper contends existing regulatory objectives such as "value for money" and "security" need to be balanced with a new objective of "Seeking to promote best retirement outcomes" to give outcome based questions the priority they deserve.

Costs – The UK has successfully delivered a very low cost pension system. But is the focus on costs delivering better outcomes?

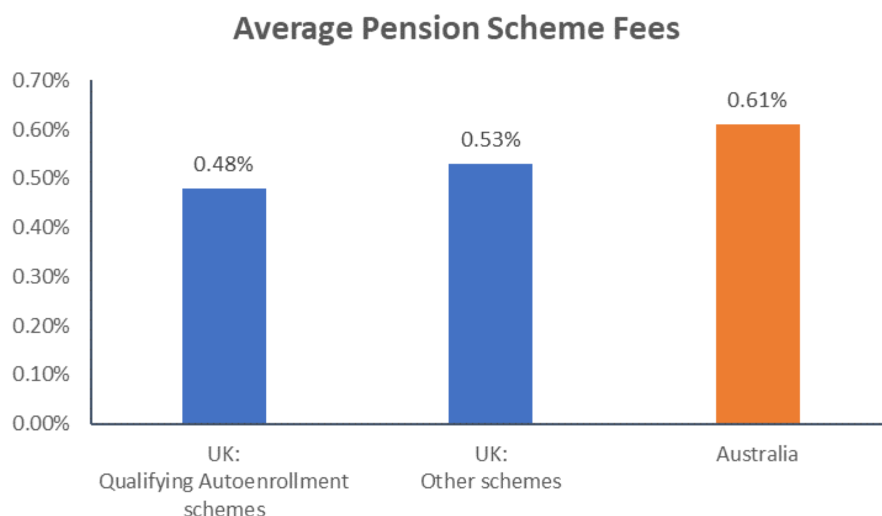
> *"The government will put pension charges in a vice and keep squeezing"*
>
> Steven Webb, Former Pensions Minister, 2014

UK Pension schemes compare well on fees to their Australian counterparts

The introduction of autoenrollment in 2013 led to a dramatic focus on pension costs. And the regulator has succeeded. Pension scheme charges are today far lower than the original charge cap of 0.75% that was introduced in 2015.

Again, comparing costs across jurisdictions is fraught with definitional differences. But the data suggests UK DC master trusts are cheaper than Australian schemes. This comes despite the smaller scale of UK schemes. And in time, with a larger population, the size of the UK schemes could overtake that of Australia, and so the comparative cost advantage of UK schemes may grow[38].

37. Source: ONS, based on the 55 to 64 year old cohort having a median pension pot of £107,300
38. UK data from DWP research Link Australian data from International Organisation of Pension Supervisors Link



Is the focus on fees helping deliver better outcomes?

As shown in the previous section, the lower costs of UK schemes has not led to UK schemes outperforming Australian. This suggests that the focus on fees may be secondary to other elements in creating good outcomes for savers.

Indeed, the UK's focus on "value for money" meant costs have been a stumbling block for increasing allocations to expensive but successful asset classes like private equity, infrastructure, venture capital. Such allocations cost more, but have substantially boosted returns for their holders[39].

After the Mansion House speech, the government has announced performance fees will be removed from the pension fee cap[40]. While this is a welcome step, the industry focus on fees remains intense and a key unresolved issue in changing allocations to include more private assets[41].

By contrast, the more outcome orientated world of Australian superannuation creates a performance culture, where investment in expensive but successful asset classes like private equity or infrastructure are easier to justify. For years, superannuation funds have been able to have substantial allocations to these asset classes – without needing a Mansion House type compact.

Fees and costs: conclusions

The focus on Value for Money has been remarkably successful in driving down costs. This remains a clear success. On the other hand, the focus on costs has left other issues unaddressed, such as UK pension fund's limited investments in high performing but expensive asset classes. Policymakers need to have outcomes as their top priority. The existing focus on value for money should be made a supplementary objective and balanced with wider measure of financial best interest.

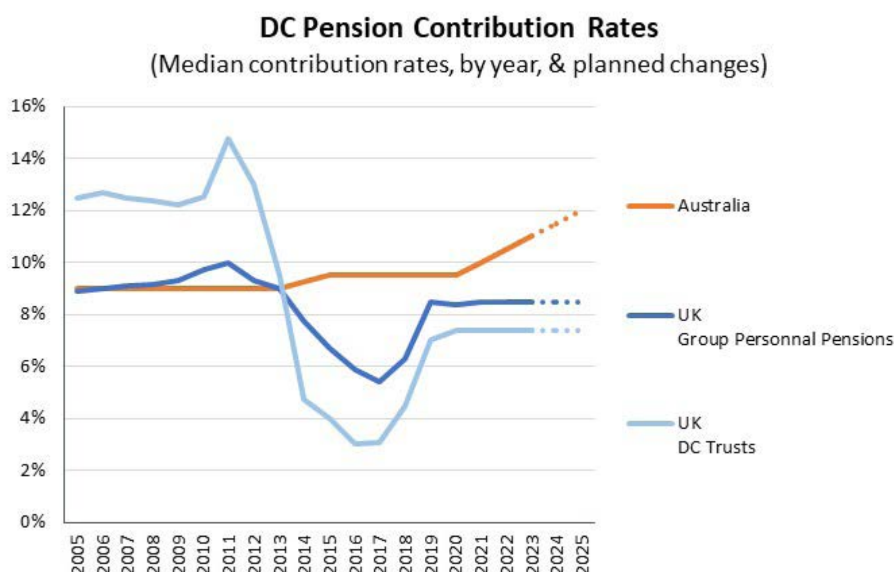
These changes coupled with the league tables proposed earlier will give pension providers both the freedom and incentive to focus on performance.

39. See Unleashing Capital, Figure 18, Link
40. See DWP paper Link
41. Example of fees being the roadblock, see concerns floated by the industry body PSLA here and reports of the difficultly moving to higher unlisted weights here

Other lessons from Australia: Contribution rates, advice, and tackling inflation

Australia offers lessons in boosting contribution rates

The UK political debate on pensions tends to focus on the state pension and the triple lock. DC pensions are not front page politics. The lack of political focus has allowed UK average contribution rates to decline as pensions have moved from DB to DC and AE. By contrast in Australia, contributions have ratcheted ever upwards to a planned 12% starting in 2025[42].



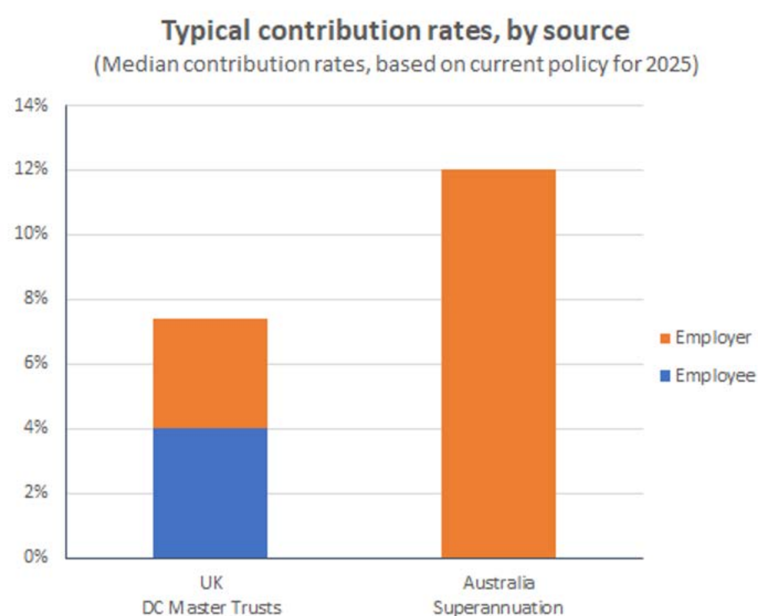
In Australia employers (not employees) pay the DC contributions

Perhaps there is a link between the popularity of 'super' (and the political focus on the topic) and the question of who pays. In 1996 the incoming Howard government cancelled obligatory employee contributions. Since then, employer contributions have been the focus.

The result is pension contributions in Australia are rising to 12%, all of which comes from the employer (and is mandatory). With employers paying, superannuation is understandably popular.

Currently, in the UK, the minimum contribution levels are 8%, with only 3% coming from the employer, (and employees can opt out of their share).

42. UK data from Pension Policy Institute, DC future Book 2023 Link
Australia data the Australia Tax Office Link



This difference in who pays helps explain the popularity of super in Australia, the electoral relevance and political support it commands.

Two birds one stone: Increasing pension contributions to tackle wage inflation

The stagnation of pension contributions in recent years needs changing. Higher levels of contributions are needed to sustain retirement incomes. The current high levels of wage growth provide a good opportunity to increase contributions. Such steps may at the same time may also help tackle inflation.

In a nutshell the proposal is slightly lower pay rises in return for slightly more pension.

Just as Australia found, doing so can help tackle an inflationary pay spiral. In 1983, Canberra wished to give workers a pay rise without that pay rise feeding into inflation. The solution was a 3% pay rise – but earmarked for pensions. Superannuation was born.

There are many parallels with the situation facing the UK. Wage growth in 2023 was around 6%[43] - with the Bank of England highlighting this risks creating an inflationary loop. Government policy could step up pension contributions to help both dampen the inflationary wage spiral and bring about better pension outcomes.

As an illustration of how this could work: our proposal is lifting contributions by 0.5% per year. After 4 years, the 8% current total contribution rates would reach 10%, and we recommend pausing to review and see if there is appetite for further increase. Contribution rates would still be shy of Australia's 12% rate, and while there would be a strong case to continue, it is always prudent to be flexible.

We focus these changes on employer contributions. At 3%, today these are low. The equivalent figure in Australia is 12%. During this time, we expect the change to contribution rates would be taken into

43. See ONS data Link

account by employers so that pay awards would be less buoyant during this four year period

In a year like 2023, that would mean rather than a 6.0% level of wage growth, employers could give a 5.5% pay rise and a 0.5% additional increase in pension contributions.

This change of 0.5% per year is chosen to be a slower, steadier pace than the larger step change in contribution rates that were introduced in the past. The slow and steady approach of 0.5% additional contributions per year is also currently deployed in Australia during their recent increase in levies.

This marks a change from how the UK has done things in the past. For example, in 2019, autoenrollment contributions jumped by 3% (with both employees and employers shouldering additional levies), having jumped by the same amount also in the prior year.

Historic and proposed Autoenrollment contribution rates[44]

Date effective	Employer minimum contribution	Employee contribution	Total contributions
2012 until April 2018	1%	1%	2.0%
April 2018 to April 2019	2%	3%	5.0%
April 2019 onwards	3%	5%	8.0%
Proposed: Year 1	3.5%	5%	8.5%
Year 2	4.0%	5%	9.0%
Year 3	4.5%	5%	9.5%
Year 4	5.0%	5%	10.0%

Sensitivity to these proposed changes is another reason why we recommend reviewing the impact after 4 years, rather than fully closing the gap with Australia.

Comparison to history in the UK and the parallel ongoing experience in Australia shows a steady pace makes such changes digestible. But should the burden prove too much for the corporate sector (for instance if it is not partially balanced with lower wage growth), there is always the option of an offsetting cut to corporation tax at a later date. And the recommendations in this report are a downpayment on the "smart regulation" agenda of creating an outcomes-orientated approach properly imbedded in within all areas of regulation. Policy Exchange's Re-engineering Regulation research gives numerous other examples across a range of industries and sectors.

Ultimately, increasing contributions is a key route to boosting living standards in retirement. As such, this will help break the inflationary wage spiral the UK has recently been fighting, without negatively impacting total employee compensation.

44. DWP Automatic Enrolment evaluation report 2019

Different models for advice

A growing "advice gap" in the UK market has long been recognised. Independent financial advice is expensive, dissuading many from seeking help. Free impartial guidance is available in the UK, e.g. via Pension Wise, but take-up has generally been viewed as poor[45].

By contrast, Australian superfunds have the ability to give basic financial advice for a low cost. Webinars and even direct meetings are possible in a way that would simply not be allowed in the UK. Perhaps the not-for-profit / mutual nature of many of the large industry superfunds with high levels of trust allows such interactions. Either way, the UK government should consider alternative models of providing access to affordable financial advice.

Innovation in the annuity space

The UK has seen a collapse in interest in annuities over the past two decades. Annuity sales fell 90% from around 500,000 in 2009 to around 50,000 in 2022[46], precipitated by a combination of pension freedom and increasingly unattractive annuity rates.

While Australia did not have the catalyst of pension freedoms, it too saw a similar decline in annuity purchases as the global low interest rates meant annuities rates drifted ever lower. But while the UK regulator remained rigidly focused around the stale assumption of an fixed-income-for-life annuity purchase, in Australia regulators shifted gear.

With a can-do attitude, Australian policymakers innovated and introduced specific rules to encourage 'innovative retirement income stream' products. This spurred rapid innovation to include offering annuities where the payments are not fixed but can grow, albeit without guarantees[47]. These variable (investment linked) annuities (see examples here and here) have since become commonly offered and have rekindled the annuity market. UK regulators have not eased rules in a similar way.

Australia's regulatory focus on retirement income more easily allows this type of lateral thinking. In the UK regulators have constrained themselves to thinking largely about 'value for money' and have shied away from thinking about the whole value chain. The result is such products are hard to find, if at all.

45. Poor take up highlighted in Link
46. PPI DC future book Link
47. See Australian legislation Link which triggered the creation of certain variable investment linked annuity products. In the UK, such products are hard to find

Sufficiency and suitability			
	UK Auto-enrolment	Australia Superannuation	Comment
Employee contribution levels	5%	0%	Australia: Employer contribution levels currently 11%, rising to 12% by 2025. Minimum employee contributions were scrapped in the 1990's. Superfunds are able to give basic financial advice over the phone or run webinars etc. Such advice is largely free or for a nominal cost (e.g. A$295 for transition to retirement advice) Outcomes in other parts of the value chain also monitored. For example, creative solutions to low annuity rates were encouraged with specific legislation, fostering certain variable annuity products that could offer more attractive rates (see example). UK: minimum contribution levels currently 8%, with employees contributing the bulk at 5% and only 3% coming from employer. For advice, while certain free resources do exist, take up is patchy. Some employers offer free advice. More often schemes offer facilitated advisors. Generally these may cost £1000 or more[48].
Employer contribution levels	3%	11%	
Minimum total contribution levels	8%	11%	
Explicitly encouraging innovation (e.g. in the annuity space)	No	Yes	
Ability to give basic financial advice	No	Yes	

48. Example of a UK advice charging schedule Link

Conclusions

The UK pensions market is changing. DB has shifted to DC. Autoenrollment and pension freedom has been introduced. Mansion House reforms are on their way.

Yet UK regulators have inherited frameworks which were originally built around defined benefit schemes. Existing regulatory approaches have prioritised concepts such as safety and value for money that were crucial for legacy DB schemes, but their approaches give little emphasis on the outcomes that matter more for DC members.

Arguably concepts such as value for money made sense in 2012 when autoenrollment was introduced. Now, having successfully reduced costs for savers these same concepts are allowing a system to flourish where certain risk profiles are too low, private market exposure too low, performance too low with low levels of contestability, all of which this report has shown gives rise to outcomes that are less than ideal.

This report argues that as UK pensions increasingly mimic the broad parameters of Australian superannuation the UK can equally learn from the Australian regulatory frameworks that focus more on the end goal – creating sufficient retirement income and growing savers' capital.

Changing regulatory frameworks can change incentives for the entire industry. Shifting the focus from value for money to outcomes has a potential to boost returns to Australian levels - particularly for the pre-retirement cohort who have suffered the most under the current UK approach – and could be worth around £12,000 to a typical pension pot of £100,000.

Beyond the gains to savers there is an opportunity to create a virtuous circle. More savings means more economic robustness, more capital for economic investment and all underpinned by better investment performance. It is time to seize the opportunity that comes from Growing Pension Capital.

Expanded detail on our recommendations

5. **Introduce a new high level objective of "Seeking to promote best retirement outcomes" for regulatory bodies including The Pensions Regulator and the FCA.**

   Currently, UK policy makers, such as The Pension Regulator state their objectives as promoting concepts such as "value for money" and "security". While these are worthy features which were highly relevant to DB schemes, the same objectives are now leading to problems in DC . For example for DC schemes, the focus on value for money rewards a low cost system but one where certain risk profiles are too low, private market exposure too low, performance too low with low levels of contestability.

   Existing objectives such as "value for money" and "security" ought to be downgraded to supplementary objectives, with an additional new supplementary objective of "supporting financial best interest".

6. **The Pension Regulator should launch and maintain a centralised portal of DC pension fund performance.**

   Currently, savers have very little Information on how a given pension scheme performed relative to peers. This applies to both younger savers (or their employers) making their first choice of pension or for older savers who might have a variety of pension pots. Our proposal is to create an official league table of performance, where information is presented on a like-for-like, after-fee basis. This is directly modelled on the database maintained by APRA in Australia.

   The initial focus would be on DC Master Trusts, but with a view to extending coverage to the defaults offered within large group personal pensions. This will increase transparency, contestability, and will give consumers a better opportunity to compare investment decisions being made on their behalf.

7. **The Pension Regulator should review and reverse the regulatory preference for derisking strategies and 'lifestyling'.**

   Existing regulatory priorities have forced schemes to adopt overly defensive asset allocations for older savers known as "lifestyling" that has led to poor performance, particularly for savers close to retirement. Perhaps this approach made sense when annuities were compulsory but now after the Pension Freedoms reforms this no logic no longer holds. The lifestyling approach is not enforced to the same extent in Australia, demonstrating that good regulations do not need to go down this path.

   As an alternative to lifestyling, regulators should consider ways to boost innovation in the annuity market, for instance by changing rules - as Australia has done - to allow innovative retirement income products such as investment linked annuities to flourish.

8. **Savers need to save more. We propose increasing the overall autoenrollment minimum contribution rates by 0.5% per annum for 4 years, to raise the overall contribution rate from 8% to 10%.**

   In recent years pension contributions have stagnated. Higher levels of contributions are needed to sustain retirement incomes. The current high levels of wage growth provide a good opportunity to increase contributions and so may help tackle inflation. This is similar to the original introduction of superannuation in Australia which was initially introduced partly to give a "pay rise" but to avoid this being inflationary. We recommend the additional contributions to come from higher employer contributions, which at 3% are currently low – the equivalent figure in Australia is 12%. We suggest raising these contributions by 0.5% per year.

   This change of 0.5% per year is chosen to be a slower, steadier pace than the larger step change in contribution rates that were introduced in the past. For example, in 2019, autoenrollment contributions jumped by 3% in one year (with both employees and employers shouldering additional levies). Using a slow and steady pace of change is again a approach deployed in Australia.

   Nevertheless, we expect that employers will take additional pension contributions into account during annual wage negotiations. Funding therefore implicitly partially comes from a likely reduction in annual wage gains. For example, the current c.6% wage growth could fall to 5.5%. As such, this will help break the inflationary wage spiral the UK has recently been fighting, without negatively impacting total employee compensation.

£10.00
ISBN: 978-1-917201-13-1
Policy Exchange
1 Old Queen Street
Westminster
London SW1H 9JA
www.policyexchange.org.uk