Pension transfer incentives: The big debate

Summary
- The use of pension transfer incentives is controversial, with some stakeholders calling for a complete ban. Proponents say incentives promote engagement, while opponents say they influence savers to make financially unsound decisions.
- A lack of value comparability between pension providers makes it difficult for both savers and advisers to discern the benefits of specific schemes.
- The subjective nature of value means transfer decisions are not purely financial, with some savers prioritising other value factors such as brand recognition or service quality.

Chloe Whelan considers the arguments for and against pension providers offering cash incentives to savers who transfer into their scheme from a competitor

As a result of pension auto-enrolment, the majority of UK workers (88 per cent in 2022) are now saving for retirement, including low-income earners and frequent job-hoppers. While this outcome is commendable, helping to address formerly low levels of pension coverage, it has also given rise to fresh challenges.

Most DC savers are defaulted into their pension scheme and acquire a new pot with each job change, resulting in some 12 million unused, small-value pension pots. Many of these members will need to transfer between providers to consolidate their retirement savings, usually towards the end of their working life. Additionally, they may never engage with their pension provider before making that decision.

In response to this disengaged landscape, some pension providers offer cash incentives to savers who transfer their scheme from a competitor.

Proponents of pension transfer incentives say they help consolidate the UK's proliferation of small pots while encouraging savers to take an active role in retirement planning.

However, pension transfer incentives are also highly controversial. They are considered a 'red flag' under government regulation, meaning schemes can delay or block members attempting to transfer to a provider after being offered an incentive. Some pension professionals have called for a total ban, raising concerns that incentives persuade savers to make transfers that deplete their savings over the longer term.

Transfer incentives are expected to be a focus of the Department for Work and Pensions' (DWP) ongoing attempts to improve the transfer process. But how can savers be empowered to make sound transfer decisions, bearing in mind that the best outcome will vary from person to person?

"Pension transfer incentives ... compel savers to act and not think"

'Act, don't think': Controversy around transfer incentives

Pension transfer incentives are a regulatory red flag, allowing trustees to delay or even refuse a transfer request if a saver has been offered an incentive to move their pension.

However, some stakeholders say this roadblock does not go far enough. People's Partnership, for instance, has called for a complete ban after finding incentives make savers more likely to switch their pension to a less profitable option.

People's Partnership's study, conducted by the Behavioural Insights Team, surveyed over 5,500 savers and found participants were 20 per cent more likely to say that they would transfer their pension after seeing a £100 cashback offer. This was despite analysis suggesting that higher fees charged by the new provider would leave them more than £1,000 worse off after just five years.

People's Partnership CEO, Patrick Heath-Lay, attributes this outcome to a lack of transparency regarding pension fees and investment performances, making it difficult for savers to calculate potential savings.

"It's incredibly financially challenging for someone to work out the long-term impacts of their chosen pension provider," he says.

"The difference between a scheme that charges 0.4 per cent and 0.75 per cent doesn't sound like a big difference but calculating that impact across decades, during which savings are likely growing and compounding, is extremely difficult."

Pensions Administration Standards Association (PASA) president, Margaret Snowdon, also opposes pension transfer incentives, saying they compel savers to "act and not think".

Snowdon proposes an alternative model by which schemes may offer incentives that purely promote engagement but are not contingent on a transfer taking place.

"I believe it's completely fine to offer a cash incentive in exchange for someone's time, so that they listen to what you have to offer," she says.

"However, that incentive should be paid out regardless of the saver's final decision. Ultimately, savers should be free to transfer or walk away, confident that they made the right decision without being swayed unfairly in either direction."

In defence of incentives

Others in the industry advocate in favour of transfer incentives, viewing them as a tool to promote engagement.

Hargreaves Lansdown, for instance, offers cash incentives during promotional periods that vary in size depending on the amount transferred. The organisation's head of communications, Danny Cox, says these incentives encourage savers to take a proactive approach to retirement planning.

"Very few people wake up on a Monday morning and say, 'oh great, I need to look at my pension,'" Cox says.

"People need encouragement to engage and giving them a financial incentive has been shown to work. We need ways to nudge people to engage with their pension planning because, ultimately, it's for their own and society's benefit."

Hargreaves Lansdown's incentives are paid out only after a transfer takes place. When asked whether the company would consider incentives that are not contingent on a transfer, akin to Snowdon's model, Cox says these "just wouldn't be commercially viable".

"You'd have to significantly reduce the size of the incentive," he said.

Several pension professionals also expressed dissatisfaction with the flagging system, saying they wished to see less regulation in the transfer process. PensionBee, for instance, has accused several of its competitors of abusing the legislation to block members from making legitimate transfers.

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The Lang Cat director of public affairs, Tom McPhail, says he could not comment on PensionBee's specific experience, but raises concerns that a complete ban on transfer incentives would only add red tape for savers.

"Many schemes receive transfer requests and go through a laborious process of back-and-forth that can take several months," McPhail says.

"I have a strong suspicion that there is an element of bad faith in the way some schemes choose to resource their transfer departments. We need to standardise and simplify that transfer request process across the industry. That is in everybody's best interest."

Cox agrees: "The best markets exist where people can move their money around as freely and easily as possible. They need to understand the benefits they may give up if they transfer, but ultimately people should be free to move their money around as they wish."

Defining value

Further complicating the issue is the lack of comparability between pension providers, which makes it difficult to discern true value-led opportunities.

The Financial Conduct Authority will consult on new reporting requirements this year in an attempt to improve value comparability. Less than one-quarter (24 per cent) of DC schemes complied with reporting requirements in 2022, according to government figures.

Heath-Lay says this lack of comparability meant even engagement-led incentives were unacceptable.

"Many schemes can't provide specific advice because it's very difficult to compare their offerings to those of competitors," he says.

"There is a fundamental lack of comparability between providers. Incentives only pour petrol on that fire, making people blind to already highly convoluted details. I don't see incentives playing any role in the transfer landscape until we tidy up comparability."

Additionally, value is a subjective term, meaning some savers may prefer a pension transfer even if it carries a negative financial impact.

McPhail says: "Value means different things to different people, and it should be up to an individual to move to an arrangement that better suits their needs.

"A pension provider may have low charges but very poor service and few investment choices. In those cases, an individual may choose to transfer even if it means they pay more and that's a very legitimate decision."

Snowdon agrees and says her concerns only arose when higher fees were untransparent.

"Every day, people happily take on contracts that have high fees because they enjoy the prestige, the brand, the service offered by a particular provider," she says.

"However, many providers aren't being clear about the costs that apply over the lifetime of a contract. My concerns lie with those savers who don't want to pay high fees, don't know they're paying high fees and are being misled."

Written by Chloe Whelan a freelance journalist