Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Telephone: 020 7066 9346
Email: enquiries@fs-cp.org.uk

Work and Pensions Committee
https://www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/inquiries/parliament-2017/inquiry11/

3 September 2018

By online submission

Dear Sir/Madam,

Financial Services Consumer Panel response: Work and Pensions Committee's inquiry on pension costs and transparency

This is the response of the Financial Services Consumer Panel (the Panel) to the Work and Pension Committee's inquiry on pension costs and transparency.

The Financial Conduct Authority (FCA) is required to set up and maintain a panel to represent the consumer interest. The Panel represents the interests of all groups of financial services consumers and operates independently of the Financial Conduct Authority. The emphasis of its work is on activities that are regulated by the FCA, although the Panel may also look at the impact on consumers of activities that are not regulated, but are related to the FCA's general duties.

The Panel highlighted problems with investment costs and charges in two 2014 reports on retail markets[1] and in a 2015 report on pensions (2015).[2] The FCA commissioned research from Novarca that busted the myths about the perceived barriers to greater transparency in reporting costs and charges within personal pensions.[3] The time for change is long overdue.

We have responded to the FCA's consultations on Retirement Outcomes, and its Asset Management Market Review[4], and the DWP's consultation on costs, charges and investments in DC occupational pensions[5] - all of which address the issues highlighted in the committee's terms of reference.

[1]Rajiv Jaitly, *Collective Investment Schemes Costs and Charges*, (2014) https://www.fscp.org.uk/sites/default/files/investment_jaitly_final_report_full_report.pdf; David Pitt-Watson, et al., *Investment Costs: An Unknown Quantity* (2014) https://www.fscp.org.uk/sites/default/files/investment_david_pitt_watson_et_al_final_paper.pdf

[2]Dr Christopher Sier FRSA, *The Drive towards Cost Transparency in UK Pension Funds,* (2016) https://www.fscp.org.uk/sites/default/files/finalthe_drive_towards_cost_transparency_in_uk_pension_funds_2015_2016.pdf

[3] https://www.fca.org.uk/publication/research/transaction-costs-transparency-research.pdf

[4] https://www.fs-cp.org.uk/sites/default/files/fscp_response_asset_management_market_study_cp17_18.pdf

[5] https://www.fs-cp.org.uk/sites/default/files/fscp_response_dwp_disclosure_of_costs_charges_and_investments_in_dc_occupational_pensions.pdf

The Panel welcomed the opportunity to participate in the FCA's Institutional Disclosure Working Group which developed asset class templates for asset managers to report costs and charges to Trustees and Independent Government Committees (IGCs). The Group made recommendations to the FCA about the future use of the templates. These included the arrangements that needed to be in place to ensure the templates are maintained; how to encourage providers to offer information using the templates; and how to encourage more users to request information from their providers. The Group recommended that use of the templates should be voluntary, relying on investor pressure on managers. The Panel would like to see the FCA, TPR and DWP encourage use of the templates and ensure Trustees are trained to assess value for money. We have also pressed for an independent 'keeper' of the templates to ensure consistency.

The FCA is relying on MiFID II and PRIIPS for cost disclosure improvements but it is too early to know whether these regulations will address the fundamental industry incentive to make costs and charges information and its impact on performance complex and opaque.

Consumers need clarity about what they are paying for their pension, including fund charges.

The best way of providing cost information to pension scheme members still needs to be determined, but industry has made some steps in the right direction. A disclosure regime alone will not be enough.[6] Therefore, we have called on policy makers to consider the feasibility of a single investment management charge. This would mean *all* costs, charges and expenses being borne directly by the asset management firm and reflected in a single charge to the investor. This would include implicit costs, which the Panel has always argued *are* possible to estimate.

As well as making comparison easier, a single charge would put incentives on asset managers to be more efficient.

Yours faithfully

Sue Lewis

Chair, Financial Services Consumer Panel

[6] https://www.fscp.org.uk/sites/default/files/investment_discussion_paper_investment_cost_and_charges.pdf

Responses to questions

1. Do higher-cost providers deliver higher performance, or simply eat into clients' savings?

The FCA's Asset Management Market Study found no clear relationship between charges and the gross performance of actively managed retail funds in the UK.[7] It even found some evidence that investors paying higher prices for funds, on average, get worse net returns.

The recent 'closet tracking' scandal exposed how fund managers were charging investors 'active' management fees for funds that essentially tracked one or more indices: the 'active' manager was not picking stocks at all. Of the 84 funds the FCA investigated, nearly 75% needed to change their marketing to ensure there was adequate disclosure of how investors' money was being managed. The FCA's investigation led to £34m in compensation being paid back to investors who had been overcharged.[8]

This suggests high-cost providers do not necessarily deliver high performance.

2. Is the Government doing enough to ensure that workplace pension savers get value for money?

Automatic enrolment means that an extra £11 billion a year is put into pension savings by around six to nine million people either newly saving or saving more into a pension. Auto-enrolled members rely on their employer to pick a good scheme, and on Trustees or IGCs to ensure they are getting value for money.[9]

While DWP has capped member charges at 0.75% for default funds in occupational schemes,[10] as the cap excludes transaction and some other costs, it is effectively meaningless as costs can be hidden elsewhere.

When the FCA set up IGCs it failed to offer guidance on assessing value for money, so IGCs calculate it in different ways. Trustees also have an obligation to get value for money for their members but, again, there is a lack of consistency. The FCA should revisit its review of the effectiveness of IGCs. Please also see our response to Q7.

3. What is the relative importance of empowering consumers or regulating providers?

The inexorable move from DB to DC occupational pensions means the risk is passed to the person least able to bear it: the individual pension saver. Working out how much to save for a comfortable retirement is not straightforward. It is certain that auto-enrolment at current levels will not be enough for most people.

But the main strength of auto-enrolment – exploiting inertia – works against encouraging people to take an interest in their pension. The vast majority of auto-enrolled members – typically 98% or more - are in their provider's default fund.

---

7 https://www.fca.org.uk/publication/market-studies/ms15-2-3.pd
8 https://www.fca.org.uk/firms/authorised-and-recognised-funds/closet-trackers
9 https://www.fs-cp.org.uk/sites/default/files/fscp_final_discussion_paper_investment_costs_20160229_4.pdf
10 Occupational Pension Schemes (Charges and Governance) Regulations 2015. The FCA also introduced equivalent rules for workplace personal pensions.

Empowering consumers is an uphill struggle. Choices at retirement are complex, made much more difficult by pension freedoms. Providers are quick to exploit inertia too: ABI figures show that 94% of non-advised drawdown sales are made to existing customers, compared with 35% of advised sales.

Cost information is opaque or missing, and comparisons impossible. People lack the time, skills and energy to overcome the massive information asymmetries between them and pension providers. Being a consumer is not a job. Better information will help (see Q4) but robust consumer protection regulation will be needed for the foreseeable future, to safeguard consumers against firms' predatory behaviour.

4. How can savers be encouraged to engage with their savings?

As part of the FCA's Retirement Outcomes Review[11,] research for Occasional Paper 38[12] tested changes to the existing 'wake-up' packs. This included additional one-page reminders sent after the initial wake-up pack, an opportunity to make a Pension Wise appointment and a declaration to 'opt-out' of using Pension Wise. Reminders were partially effective in the short-term, when consumers were more likely to contact their pension provider or access their pension online. The additional one-page document after the wake-up pack, which simplified information for consumers, increased calls to Pension Wise and hits to the website.[13]

What people want is straightforward, impartial, information. An industry-led group has developed a Simpler Annual Statement, due to be launched in the autumn. This is just two pages long and sets out savings (including employer contributions and tax relief) in a simple, graphic, format. It also projects the size of the saver's pot at retirement, at current levels of saving, and with additional contributions. The statement is currently being tested with consumers.

Many people have more than one pension. A consistent format for the annual statement will be a big step forward, but it needs the Pension Dashboard to put everything in one place so that savers can get an overall picture of what they can expect in retirement. The Panel simply does not understand why the government is dragging its feet over something that could make such a difference. Although we favour compulsion on providers, it would be better to get the dashboard up and running as soon as possible. Smaller providers, or those with inadequate systems, could be added later.

Another development that may be useful is the Pensions and Life Savings Association's (PLSA) suggestion of retirement income targets. Used in Australia, these could help people plan for the kind of retirement they want.

As pension savers approach retirement, they need to make different decisions. They often think about these far too late – 'wake-up' packs have been unsuccessful and the take up of Pension Wise poor. Products are far too complex, and the opaque costs and fees of independent financial advice do not help. People want to 'take control' of their pension pot, which often means taking it out in cash and putting it in the bank. They do not think about the tax, benefits or other consequences, which may be severe.

---

11 https://www.fca.org.uk/publication/market-studies/ms16-1-3.pdf

12 https://www.fca.org.uk/publication/occasional-papers/occasional-paper-38.pdf

13 https://www.fca.org.uk/publication/occasional-papers/occasional-paper-38.pdf pg 5

The FCA has proposed earlier and simpler 'wake up' packs; and other measures such as default investment pathways to encourage people to take a closer interest in how they use their pension pot. This is all helpful, but the Panel believes it is essential to get more people to take independent, impartial, guidance at a point before they have made up their minds. The Financial Guidance and Claims Act gives the FCA responsibility to make rules ensuring that consumers accessing or transferring their savings have either taken appropriate guidance or opted out of it.

We believe an impartial organisation – in practice the Single Financial Guidance Body - should be responsible for managing this whole process. Pension providers are conflicted, they have an interest in hanging on to their customers and will exploit their inertia and fear of making a mistake to do so.

5. How important is investment transparency to savers?

The Asset Management Market Study, supported by the FCA's Occasional Paper 32,[14] clearly showed the importance of disclosure in investments. The same goes for pensions. Research published recently by VisibleThread[15] found that 98% of web-based disclosures from the 69 asset management firms they tested failed to meet "basic standards of readability".

Presenting investment information using clear, jargon-free and illustrative information helps consumers make decisions. Ideally, industry would do this voluntarily. However, it appears challenged by 'first mover paralysis.'[16]

Research has repeatedly shown that consumers do not engage with financial information shown as a percentage: they prefer it in pounds and pence. Despite its drawbacks, the PRIIPs KID should help to give clarity on costs for consumers. It makes sense to extend this requirement to all retail investments.

The Panel has recommended that the FCA ensures that all providers display the information to investors in the same format. Standardisation of data is the only way to ensure comparisons can be easily made. This will make it simpler for investors to compare charges against other providers and assess whether they are getting value for money. The exact format and presentation will need extensive consumer testing before finalising, but the research used in the development of both the PRIIPs KID[17] and the IDD's Product Information Document could be used as a starting point.[18]

6. If customers are unhappy with their providers' costs and investment performance/strategy, are there barriers to them going elsewhere?

In general, consumers face many barriers to shopping around in opaque and confusing financial services markets[19] .This applies in spades to pension saving, and generating an income from a pension pot.

---

[14] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-32.pdf

[15] https://www.visiblethread.com/company/published-reports/ *'Average readability for all websites was 36.22. Scores of 60 or higher are considered ideal.'*

[16] https://www.fs-cp.org.uk/sites/default/files/investment_discussion_paper_investment_cost_and_charges.pdf 'Disclosure is only effective if those to whom the details are provided can understand and act on the information; overly complex disclosure to consumers would be counterproductive in many cases.'

[17] https://www.fca.org.uk/publications/calls-input/priips-regulation-initial-experiences-new-requirements

[18] https://www.fs-cp.org.uk/sites/default/files/fscp_response_asset_management_market_study.pdf

[19] Consumers and competition: Delivering more effective consumer power in retail financial markets, Jonquil Lowe on behalf of the Financial Services Financial Panel, March 2017

Drawdown charges are complex and the lack of transparency means it is difficult for consumers to go anywhere other than their pension provider.

Citizens Advice found that around 70% of people accessing their pension cash since the pension freedoms took effect had not shopped around. This level of inertia means there is little competitive pressure on firms to offer good products at a fair price.[20]

Currently there are numerous costs and charges on drawdown products including transfer in (and out) charges; a charge for taking an income and a charge for not doing so (with some providers); higher charges for monthly withdrawals, and for ad hoc withdrawals. This is all before advice charges or investment charges are considered.

Products must be comparable. The FCA has already addressed this in its Retirement Outcomes Review and is currently working closely with the Money Advice Service and industry, through the ABI, to build an online comparison tool that will enable individuals to compare drawdown products from across the market. It should go further and mandate this tool.

It would show customers that the product costs them money.[21] Cost transparency should also help competition.

7. Are Independent Governance Committees effective in driving value for money?

The Panel has called for regulatory requirements on IGCs to be strengthened to bring them in line with those for Authorised Fund Manager Boards,[22] and for stronger governance structures to ensure they genuinely represent consumer interests and manage conflicts of interest robustly.

The effectiveness of IGCs and Trustee Boards is dependent on their ability to assess value for money. They cannot do this without access to clear and comprehensive information on all costs and charges. This should be standardised so that investors or their representatives can readily compare funds. Even where they know an asset manager is not giving value for money, there is little IGCs and Trustees can do to change the situation quickly. While they may be able to bring some pressure to bear on costs, it is hard for them to vote with their feet. Changing asset manager is difficult and risky, and asset managers know that.

ShareAction's report[23] filled the vacuum left by the FCA's deferral of its planned review of IGCs. The report found that IGC's annual reports did not explain clearly and simply how they held providers to account for achieving value for money for members. We support ShareAction's call for the FCA to define value for money, and to issue guidance to IGCs on how it should be measured. The FCA should also take its review of the effectiveness of IGCs off the back burner as soon as possible, especially considering the potential expansion of IGC's remit to non-workplace pensions and decumulation.

[20] https://www.fs-cp.org.uk/sites/default/files/fscp_response_hoc_work_and_pensions_committee_pensions_freedoms_inquiry.pdf

[21] https://www.fca.org.uk/publication/market-studies/ms15-2-2-annex-3.pdf

[22] https://www.fs-cp.org.uk/sites/default/files/fscp_response_asset_management_market_study_cp17_18.pdf

[23] https://shareaction.org/wp-content/uploads/2018/02/PolicyReport-IGCRanking.pdf

8. Do pension customers get value for money from financial advisers?

Independent Financial Advisers can make a good living out of people with relatively large amounts of money to invest, so have little incentive to develop more efficient, cheaper, advice models. The Financial Advice Market Review was intended to widen access to regulated advice. What it did instead, was to open the door to 'execution only' sales, often masquerading as guidance.[24]

Advice costs need to be much clearer so consumers know exactly what service they are getting and how much this service will cost. The Panel suggests that the FCA revisit the idea of a 'menu' showing average fees for certain types of regulated financial advice, as we suggested prior to the Retail Distribution Review. All fees and charges listed for each transaction must be clear and accessible for this to work.

[24] https://www.fs-cp.org.uk/sites/default/files/fscp_response_hoc_work_and_pensions_committee_pensions_freedoms_inquiry.pdf