Which? works for you

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Date: 15 December 2017
Response to: Department for Work and Pensions consultation on *Occupational pensions: improving disclosure of costs, charges and investments*

Consultation Response

Summary

- Which? strongly supports the Department for Work and Pensions' (DWP) aim to improve the transparency and disclosure of the costs and charges that consumers pay for occupational pensions and details of where their money is invested. In particular, Which? welcomes the DWP's proposals to disclose all charges and costs, including transaction costs, for each fund, and for a '£ and pence' illustration of the compounding effect.
- The DWP should also go further to:
    1. standardise the presentation of '£ and pence' illustrations of the compounding effect of total costs and charges;
    2. prohibit references to historical investment performance as a justification for higher charges;
    3. require pension schemes to report on the costs and charges of underlying pooled funds;
    4. require the proposed disclosures of costs and charges to be included in annual benefit statements; and
    5. require all pension schemes covered by the proposals to make the new disclosures available online as well as to members.
- Other complementary policies, including the pensions dashboard and auto-enrolment charge cap, are also crucially important for ensuring good outcomes for consumers.

Which? strongly supports the DWP's aim to improve the disclosure of costs, charges and investments for occupational pensions

Which? welcomes the DWP consultation on the disclosure of costs, charges and investments in DC occupational pensions. We also welcome the DWP's survey of members of pension schemes, and we have encouraged Which? members and supporters to answer the questions it contains.

High pension charges are one of the largest sources of detriment to UK consumers, substantially eroding the value of future retirement income. The Financial Conduct Authority (FCA) has concluded that the upstream asset management part of the £3tn UK pensions market is characterised by 'little evidence that firms compete on the basis of price' and that there is 'no clear link between price and performance'.[1] Consequently, consumers can lose a significant share of their pension savings in costs and charges. For example:

[1] FCA (2016), *Asset Management Market Study – Interim Report*, p.92

- The DWP's recent pension charges survey found that 8 out of 10 (79%) members of contract-based schemes and half (50%) of members of trust-based schemes that are not covered by the auto-enrolment charge cap are paying fees that are above the charge cap of 0.75%.[2]
- Which?'s recent review of 17,000 popular retail funds offered by pension providers found that more than 1,000 listed annual charges of 2% or more; around 2,300 charge between 1.5% and 1.99%; and more than 5,500 charge between 1% and 1.49%. For someone saving between the ages of 25 and 65, for example, annual charges of 2% could mean that when they retire they have lost a third of their pension savings in charges.[3]

Up to 300 different charges are taken from investment and pension schemes according to the Transparency Task Force,[4] and many charges remain hidden – not just to members and employers, but to trustees and managers of pension schemes. The FCA's Institutional Disclosure Group therefore recently estimated that the total average cost to consumers of pension funds is 3% of assets under management. A third of this, which amounts to £35bn, is being taken from consumers in hidden charges.[5]

Consumers have the right to know how much they are paying for any good or service, and what they get in return. Members of workplace pension schemes often have a choice of investments, and in some cases can opt out of their current employers' chosen scheme. Members benefit from the scrutiny of trustees and independent governance committees. However, this is not always sufficient to protect members' interests. The Pensions Regulator (TPR), for example, recently concluded that around a quarter (23%) of members were in a trust-based pension scheme that was not meeting TPR's expectation that trustee boards must assess the extent to which charges and transaction costs provide good value for members.[6] We therefore strongly support the DWP's and FCA's reforms to improve the transparency of total costs and charges, and to provide better information to consumers.

In particular, better information can help to put downward pressure on costs and charges, even if most members of workplace pension schemes do not engage significantly with their pension. A small minority of members can exert pressure on trustees to shop around to reduce charges. So if a small minority of consumers become engaged through better transparency of costs this can still impose a strong competitive discipline on the market. Greater transparency can also help other organisations to put pressure on employers and pension schemes to reduce charges, as long as this information is made publically available in a comparable and easily-accessible format.

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[2] Department for Work and Pensions (2017), *Pension Charges Survey 2016: Charges in defined contribution pension schemes*, p.18

[3] A 25 year old starting their first job and contributing £200 each month to a pension (net of tax relief and employer contribution). If the contributions increase by 3% each year as her salary grows and she enjoys annual returns of 5%. By the time she turns 65, after working and saving for 40 years, she would have saved a respectable £476,000. However, once you factor in annual fees of 2% she is left with only £313,000. Which? (2017), *Are pension charges costing you thousands of pounds?*, http://press.which.co.uk/whichpressreleases/are-pension-charges-costing-you-thousands-of-pounds/

[4] These include administration, investment and risk management fees, client communication, legal, governance, regulation, compliance and intermediary fees. Transparency Task Force cited in Valentina Romeo (2016), 'Taskforce reveals 300 charges in bid to cut 'hidden' fund costs', *Money Marketing*, 6 July 2016

[5] Patrick Hoskin (2017), 'Funds tsar Chris Sier declares war on hidden fees: 'Arrogant City managers taking £35bn too much'', *The Times*, 11 December 2017

[6] The Pensions Regulator/OMB Research (2017), *Defined contribution trust: A summary report on the 2017 research survey*, Figure 3.1.1.1, p.9

Which? welcomes the DWP's proposals to disclose all charges and costs, including transaction costs, for each fund and for a '£ and pence' illustration of the compounding effect

Which? supports proposals for occupational pension schemes to publish information on charges and transaction costs and to disclose this to members, beneficiaries of the scheme and others including recognised trade unions. We particularly welcome the inclusion of transaction costs – which are defined in legislation as 'the costs incurred as a result of the buying, selling, lending or borrowing of investments'.[7] It is also right that these requirements, as well as extended requirements for chair's statements, will apply to the charges and transaction costs for each default arrangement and any alternative fund choices. We agree that existing chair's statements, which simply provide an upper and lower bound where there is more than one default or alternative fund, do not provide sufficient information for members to understand what charges they are paying or to compare their fund options.

As we have previously argued in our response to the DWP's review of the auto-enrolment charge cap,[8] it is the total cost paid for by consumers, including transaction costs, that should be of concern to policymakers and regulators, especially considering that:

- transaction costs are ultimately within the control of providers, as transaction costs are a direct function of investment strategy and shopping around for best pricing; and
- transaction costs can more than double the total cost to consumers of a pension,[9] and can include more than 40 different costs.[10]

There is currently little transparency of transaction costs and so there is weak or no competitive pressure to minimise these costs. There may also be incentives to inflate such costs. For example:

- The Office of Fair Trading (OFT) raised concerns about the lack of visibility of transaction costs within investment funds, concluding that, as a result, it is unlikely that competition can effectively be brought to bear on them. The OFT also raised concerns regarding the potential for conflicts of interest to emerge in the supply chain such that non-visible charges may not always be managed down in the interests of scheme members. [11]
- The DWP's 2015 pension charges survey found that most pension providers were unable to provide an estimate of the transaction costs that their members were paying.[12] The DWP's latest pension charges survey concluded that there was 'virtually no improvement' in providers' abilities to report on transaction costs.[13]

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[7] *The Occupational Pension Schemes (Charges and Governance) Regulations 2015*, Part 1: Introduction

[8] Which (2017), *Department for Work and Pensions Review of Automatic Enrolment: Default Fund Charge Cap*

[9] 'Transaction costs were not straightforward for providers to measure, although four providers [of 12] were able to produce broad estimates of these… Two reported that they typically equated to between zero and 0.75 per cent per annum.' Transactions costs of 0.75% could double the charges paid within schemes covers by the auto-enrolment charge cap, which is set at 0.75% and excludes transaction costs. Department for Work and Pensions (2015), *Pension Charges Survey 2015: Charges in defined contribution pension schemes, p.3 & p.21*

[10] The FCA found that the detailed list of transaction costs and other uncapped investment costs that may be incurred by a group personal pension scheme, depending on its underlying investment portfolios, is over 40 items long. FCA/Novarca (2014), *Transaction Costs Transparency*, p.4

[11] Office of Fair Trading (2013), *Defined contribution workplace pension market study*, p.18

[12] Department for Work and Pensions (2015), *Pension Charges Survey 2015: Charges in defined contribution pension schemes, p.38*

[13] Department for Work and Pensions (2017), *Pension Charges Survey 2016: Charges in defined contribution pension schemes*, p.20

The FCA's new disclosure rules for transaction costs, which come into force for fund managers in January 2018, will ensure this information is provided to pension schemes in a standardised format. It is only right that pension schemes use this information to provide members with a more complete picture of the total costs that affect their pension savings.

Furthermore, we support the proposal for pension schemes to be required to publish details of the compounding effect of costs and charges, including transaction costs, and a '£ and pence' illustration. The FCA's consumer research has highlighted how similar measures can make it easier for consumers to understand the effect of costs and charges, and to make comparisons between different products. An experiment for the FCA's retirement outcomes review,[14] for example, found that the introduction of 'pension savings available after costs'[15] or 'average cost per year'[16] cost metrics helped participants to identify the cheapest retirement income product.

The DWP should also go further to:

1. **Standardise the presentation of '£ and pence' illustrations of the compounding effect of total costs and charges**

While the DWP's proposals will require trustees or managers to present a '£ and pence' illustration of the compounding effect of total costs and charges, the proposed guidance for pension schemes to follow does not prescribe how to present this information. Instead, it is 'is up to the scheme to decide'. This is at odds with other regulatory initiatives that seek to standardise how information is presented, which can help to aid comparisons and ensure that there are sufficient minimum standards. For example:

- Annual percentage rates (APRs) are required for cost information provided to consumers for consumer credit. The objective, which is set out in the Consumer Credit Directive, is a standardised and comparable measure of the total cost of credit. Regulations set out in detail how the total charge for credit and the APR should be calculated and presented.
- For institutional investors, the FCA's asset management review recommended that 'industry and investor representatives agree a standardised template of costs and charges'.[17] This work is currently being undertaken by the FCA's Institutional Disclosure Group.
- The OFT concluded that employers 'are likely to find it difficult to compare charges of different pension providers because there is a lack of consistency in the way charges are presented.'[18]

In designing how to present this information to members, different approaches should be researched and tested with consumers. We are concerned that pension schemes may have

[14] FCA/Oxera/Nuffield Centre for Experimental Social Sciences (2017), *Annex 5: Identifying metrics to aid consumer choice in the income drawdown market*
[15] 'The estimated present value of a pension after taking account of the impact of all drawdown charges over the next twenty years.'
[16] 'The estimated average cost per year in £ charges that a customer is likely to pay on drawdown charges.'
[17] FCA (2016), *Asset Management Market Study – Final Report*, p.12
[18] Office of Fair Trading (2013), *Defined contribution workplace pension market study*, p.18

weak incentives to invest in research and testing – particularly smaller schemes, but also larger schemes. Standardising requirements for presentation, based on consumer research and testing, would ensure that all pension schemes present this information in the optimal way.

2. **Prohibit references to historical investment performance as a justification for higher charges**

We agree that it may be helpful for members to see additional contextual information on the reasons for the costs and charges they are paying. However, pension providers should not be able include references to historic scheme performance as a justification for higher costs and charges. This would contradict the FCA's analysis of the empirical evidence which found 'no clear link between price and performance'.[19]

3. **Require pension schemes to report on the costs and charges of underlying pooled funds**

We agree with proposals for pension schemes to report on costs and charges for each investment fund that they offer. However, we do not agree with proposals to exclude underlying pooled funds, such as a 'fund of funds' structure. This would mean that the costs and charges of these funds would remain hidden. The DWP argues that publishing this information could prove 'distracting and confusing for members'. While it is important to consider the unintended consequences of information presented to consumers, there does not appear to be any research cited by the DWP to support this argument in this instance. Furthermore, the alternative suggestion is that members could use fund factsheets and annual reports of any underlying pooled funds that are already available. This is likely to be too onerous for all but the most highly engaged and knowledgeable consumers.

4. **Require the proposed disclosures of costs and charges to be included in annual benefit statements**

Annual benefit statements are currently one of the primary statutory methods of providing information to members of pension schemes. However, pension schemes are not currently required to include details of costs and charges in the annual benefit statements they provide to members. At present, the chair's statement is the only way by which members have a legal right to obtain information on costs and charges. Members have to request access to the statement though, and pension schemes do not have to publish this information.[20]

The Pensions Regulator's guidance states that it is best practice for annual benefit statements to include 'information about the charges a member has paid over the year, ideally expressed in pounds and pence, as well as a percentage.'[21] It is unclear why the DWP has not proposed making this best practice a requirement for all schemes. Instead, the proposal is that each member who receives an annual benefit statement should be provided at the same time with a web address where members can find the costs and charges for their scheme. Given the inherently low levels of engagement with pensions, information on costs and charges should be

[19] FCA (2016), *Asset Management Market Study – Interim Report*, p.92
[20] The Pensions Regulator (2016), *Guide to communicating and reporting*, p.17
[21] The Pensions Regulator (2016), *Guide to communicating and reporting*, p.9

made as readily available as possible, avoiding requiring members to make additional steps to find this information. It should therefore be included in annual benefit statements as well as online.

5. **Require all pension schemes covered by the proposals to make the new disclosures available online as well as to their members**

We agree that proposals should not be prescriptive as to where information on costs and charges is published online, as the most suitable place for this may differ between providers and it may change over time. However, we do not agree with the proposal that pension schemes should be able to opt out of publishing information online if they choose, instead just providing information directly to members via cloud services or online tools. This is not consistent with the point made elsewhere in the consultation that other industry participants are likely to collate, assess and report on data to compare costs and charges across pension schemes. Such comparisons could help significantly to engage consumers and enable them to understand and compare pension schemes. This is particularly important given that the incentives on pension schemes to directly engage their members with the proposed information are likely to be weak. It is therefore important that this information is made publically available for all pension schemes. The data should also be easily accessible for third parties and in a format that allows third parties to make meaningful comparisons.

Other complementary policies, including the pensions dashboard and auto-enrolment charge cap, are crucially important for ensuring good outcomes for consumers

The OFT concluded that competition alone cannot be relied upon to drive value for money in workplace pensions, as the buyer side of the market is weak. Namely, while members contribute towards a workplace pension and bear the cost of the provision of the scheme, it is their employer that chooses the pension scheme.[22] Consumers still need to engage if they are to understand the market, shop around and switch, or consolidate their pension savings where possible. Consumer engagement is relatively low though,[23] and even with better information is likely to remain low for most consumers. As the OFT noted, this is partly because pensions are complicated products and the benefits typically occur a long time in the future.[24]

The pensions dashboard initiative could significantly increase consumer engagement. It will enable consumers to see all of their pensions in one place for the first time. However, the industry prototype delivered earlier this year only contains basic information that will not lead to the dramatic improvement in engagement that is needed. As a minimum, from 2019 the dashboard should include costs and charges, as well as other key pieces of information such as investment/fund holdings and details of guarantees and extra benefits. The Government should also set out a clear timetable for the delivery of the pensions dashboard by 2019.

Given weak consumer engagement, better information is important but not sufficient to deliver good outcomes for consumers. Other protections are also required. In particular, the charge

[22] Office of Fair Trading (2013), *Defined contribution workplace pension market study, p.15*

[23] For example, a YouGov survey of working-age individuals by B&CE, the pensions provider, found that over half (51%) of working-age people did not know whether their current pension provider was charging them to manage their savings or not. Only 11% knew that they were being charged and how much. B&CE (2015), *General public awareness of pension charges*, https://bandce.co.uk/pension-charges/

[24] Office of Fair Trading (2013), *Defined contribution workplace pension market study, p15*

cap for auto-enrolment schemes can help safeguard consumers against high charges. We have called for the cap to be regularly benchmarked to the most competitive parts of the market and updated. We also argued that the scope of the cap should be widened to include transaction costs. While the government announced in November 2017 that the current level and scope of the charge cap will remain in place, we welcome the government's commitment to review the charge cap in 2020. We are keen to work with the government to understand how the pensions and savings market is developing, and how best to benchmark the charge cap to the wider market.

About Which?

Which? is the largest consumer organisation in the UK with more than 1.7 million members and supporters. We operate as an independent, a-political, social enterprise working for all consumers and funded solely by our commercial ventures. We receive no government money, public donations, or other fundraising income. Which?'s mission is to make individuals as powerful as the organisations they have to deal with in their daily lives, by empowering them to make informed decisions and by campaigning to make people's lives fairer, simpler and safer.