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Which?

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Date: 19th June 2018
Response to: The Pensions Regulator and Financial Conduct Authority call for input on *Regulating the pensions and retirement income sector*

Summary

- The UK pensions system and regulatory environment is extremely complex. Consumers cannot reasonably be expected to understand the intricacies of the regulation.

- What consumers can reasonably expect is a robust regulatory environment and a framework that reflects the risks in the market and provides certainty as to the rights and obligations of all the parties involved. It should create an environment where choice and competition can drive beneficial outcomes. It must also ensure there is sufficient protection for consumers when choice and competition cannot be relied upon.

- There has been a significant shift in risk, from institutions and employers towards the individual consumer in recent years. It is not evident that the regulatory framework nor the supporting guidance and advice around it has yet caught up with these changes.

- The Pensions Regulator (TPR) and Financial Conduct Authority (FCA) should develop a joint strategy focusing primarily on good choices and outcomes, making sure pensions are well run and offer value for money. These should be primarily addressed through a combination of the pensions dashboard, coordinated regulation of default products in both accumulation and decumulation, and regulation and guidance aimed at creating better governance and driving down costs and charges.

- In response to the call for input, Which? ask that the FCA and TPR:

    - Support the development of a comprehensive pensions dashboard.

    - Jointly review the functioning of both Trustees and Independent Governance Committees (IGCs).

    - Use their regulatory powers and expertise to support better protections for consumers, including a lower charges cap for default pension schemes and greater transparency of costs and charges.

    - Work with Government and stakeholders to develop the necessary legal and regulatory framework to introduce default income drawdown investments and an associated charge cap for the least engaged consumers.

Detailed response

1. Which? welcomes the opportunity to respond to the call for input on the strategic approach to regulating the pensions and retirement income sector. Which? agrees that the biggest potential harm in the sector is the prospect of people not having adequate income, or the level of income they expected, in retirement and supports the FCA and TPR in their decision to develop a joint strategic approach with a focus on reducing harm.

2. The introduction of auto-enrollment has seen over 9 million people enrolled into default pension schemes. The vast majority of consumers are being enrolled into defined contribution (DC) schemes, in which individuals build their own retirement pots, rather that defined benefit (DB) schemes, where employers invest and provide a guaranteed retirement income. Subsequently there has been a shift in risk from institutions and employers towards the individual consumers. Consumers in workplace pension schemes do not choose their scheme and are unlikely to have much choice over contribution rates. They cannot be expected to engage with the market to drive competition and are at risk of having pensions savings eroded by high costs and charges. Costs and charges can substantially reduce the value of saving over time and therefore must be addressed in order to help ensure consumers are saving effectively for their retirement.

3. There is also scope to reduce detriment for some consumers through better engagement with the pensions market, particularly where consumers can be supported in making choices to ensure that have saved and prepared adequately for retirement. Better engagement could also drive competition if consumers can be encouraged to shop around and consider moving or consolidating their savings, so long as consumers can be given the necessary information to make those choices. To address these issues TPR and the FCA should develop a joint strategy focusing primarily on good choices and outcomes, making sure pensions are well run and offer value for money. Key cross-cutting aims of the strategy must be to increase consumer protections, to increase transparency and to increase the accessibility of information on pensions and retirement incomes for consumers.

4. A key tool needed to engage savers and to provide appropriate support for consumers will be a comprehensive pensions dashboard. Only by being shown all the necessary information about all of their pensions will consumers be able to make more informed decisions around both accumulating their pension savings and their retirement choices. A comprehensive dashboard must enable consumers to compare the cost and charges incurred by their pension products, consolidate their pension pots, and switch providers.The FCA and TPR must proactively work with stakeholders to ensure that they are providing the expertise and the necessary regulatory support for the development of a comprehensive dashboard.

5. To ensure effective governance for all consumers, TPR and the FCA should jointly review the functioning of both Trustees and Independent Governance Committees (IGCs) in default workplace pensions and consult on how best to ensure that any difference in governance and regulation results in fair outcomes and value for money

for consumers. This is important, as consumers on default schemes have no choice as to whether they are enrolled onto a trust or contract-based scheme.

6. To ensure consumers can expect value for money, Which? has called for a reduction in the cap on annual charges for default auto-enrolment pension schemes and for the cap to include transaction costs. Which? has also called for greater standardisation and transparency in the reporting of all costs and charges. The FCA and TPR should use their regulatory powers to drive improvements where they can, and use their unique position to collect data and analyse the market to help push for change from Government or, if appropriate, push for appropriate changes to the statutory powers of the relevant regulator.

7. There is also significant potential for consumer detriment in pensions decumulation. This is due to the introduction of pension freedoms and the lack of consumer protections, like the charges cap, the default products and the default minimum contributions introduced for accumulation. The risk to consumers will grow as an increasing number of people start to access funds saved in default DC schemes where the consumer has not had to actively engage and may have multiple pots. As a result, consumers, including those who have not previously engaged with the market, are having to make retirement income choices that should be taking into account risks such as inflation, longevity and investment returns. For consumers that are not seeking advice or making decisions, Which? continues to call for the FCA to introduce default income drawdown investments and an associated charge cap for the least engaged consumers. Again, to achieve this the FCA and TPR should work with Government and stakeholders to develop the necessary legal and regulatory framework.

Working in partnership

8. Consumers are expected to have 11 different jobs in their lifetime, and with the introduction of auto-enrollment can expect to accumulate roughly an equal number of pensions pots. As the market is split between contract and trust-based pensions, it will be reasonable to expect consumers to have a combination of contract and trust-based pensions and therefore oversight of their pensions will lie with, or between both regulators.

9. Consumers, particularly those not actively engaged with their pensions, do not and can not be expected to understand difference between default pension types and the varying functions of pension regulators. Therefore there should be no notable difference in outcomes for consumers as a result of regulatory differences, and the rights and obligations of consumers should be consistent across different default schemes. To achieve this, TPR and the FCA should increase cooperation on regulating and providing guidance to trust and contract-based default pension providers. If there are areas where either regulator believes legislative change and/or changes to a regulator’s objectives and responsibilities is required, then they should support each other in ‘making recommendations to Ministers’ and efforts to ‘inform policy-making’

as is provided for in the Memorandum of Understanding (MoU) between TPR and the FCA.[1]

10. The MoU also states 'The FCA and TPR will liaise with each other as necessary on pensions-related complaints to ensure that shared issues are given appropriate consideration.[2] This issue is not given further consideration in the call for input, however, TPR and the FCA should work to ensure that consumers are able to effectively engage with regulators, as well as ombudsmen and advice services, where appropriate. Currently depending on the nature of a concern an individual could contact:

    - TPR - for concerns about employers actions in regard to a pension, but are unable to help with disputes between individuals and schemes.
    - FCA - in relation to the application or terms of a contract-based pension.
    - Financial Ombudsman Service - which deals complaints regarding the sale or marketing of individual pension arrangements.[3]
    - The Pensions Ombudsman - which can deal with complaints about occupational and personal pension schemes. It can also consider some complaints about the Pension Protection Fund and the Financial Assistance Scheme.[4]
    - The Pensions Advisory Service (TPAS) - for general advice including on auto-enrollment rights (Since 1st April 2018 disputes are no longer handled by TPAS).[5]

11. Providing consumers with several points of access could be creating an additional burden of choice and understanding for consumers. There is concern it could lead to ineffective responses and lack of coordination from the FCA, TPR and others at a point when a consumer is already experiencing detriment as a result of an employer or pension provider failing to comply with regulation. TPR and the FCA should consider whether they could cooperate to reduce the burden on consumers, potentially by creating a single point of access for pensions related complaints.

Regulators should focus on good choices and outcomes, governance, and value for money

12. As the market shifts DB schemes towards default DC schemes the risks associated with pensions investments increasingly lie with the individual member of the scheme and not with the employer. It is therefore vital that regulation in the pensions and retirement income sector is strengthened to 'reflect the potential harms and risks in the current landscape', especially as those saving into default workplace and occupational pensions have very little means of interacting with the market.

13. The five areas identified in the call for input by the FCA and TPR are:

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[1] http://www.thepensionsregulator.gov.uk/docs/mou-fca-regulator.pdf, para 7
[2] http://www.thepensionsregulator.gov.uk/docs/mou-fca-regulator.pdf, para 19
[3] https://www.pensionsadvisoryservice.org.uk/pension-problems/making-a-complaint/jurisdiction
[4] https://www.pensions-ombudsman.org.uk/our-service/make-a-complaint/
[5] https://www.pensionsadvisoryservice.org.uk/contacting-us/online-enquiry-form

- getting savings off to a good start;
- making sure pensions are well run and funded;
- making sure pensions are safe;
- making sure pensions offer good value for money, and;
- supporting good choices and outcomes.

These five areas are the right ones to target for reducing detriment to consumers. Both regulators should work together to develop these areas into a strategy focusing primarily on good choices and outcomes, making sure pensions are well run and offer value for money.

Getting saving off to a good start: access to pensions

14. Which? supported the introduction of auto-enrollment[6], which has seen over 9 million consumers auto-enrolled onto default workplace pension schemes. The vast majority of the increase has been in contributions to DC pensions, with 91% of larger employers (more than 30 staff) and 99% of smaller employers offering DC auto-enrollment schemes[7], meaning that the consumer will have increased responsibility for ensuring that they are saving adequate levels into their pensions and will ultimately take on the risks associated with that saving.

15. Which? has called for Government to explore ways of "nudging" all individuals to save more appropriately. TPR and the FCA are in a unique position to collect data and analyse the market. As regulators they should therefore be proactive in feeding into and informing policy decisions to ensure that employers and pensions providers are reaching consumers at important "touch points" to reduce opt-outs and increase opt-ins.

16. The call for input is about a strategic approach for the future. Both regulators will need a focus on engaging those starting to save, particularly in the 18-35 age range, and ensure that work is done to prevent opt-out rates rising as auto-enrollment contribution levels rise. This will involve working proactively with both Government and other bodies. The new guidance body may provide an optimal route for this engagement. Waiting until 'mid-life' will be too late for many consumers, whose abilities' to save adequately may have already been seriously harmed by a lack of earlier intervention. The FCA and TPR must push for better education and intervention at an earlier age. These efforts should include encouraging engagement through a comprehensive pensions dashboard.

17. It is important that both regulators recognise that efforts to try to educate and engage consumers cannot be relied upon to provide 'appropriate degree of protection for consumers'[8] and to reduce detriment in a market where consumers have little ability to drive change, even where they are engaged.

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[6] https://www.which.co.uk/policy/money/2278/consultation-responses-savings
[7] http://www.thepensionsregulator.gov.uk/docs/automatic-enrolment-commentary-analysis-2017.pdf
[8] 'Securing an appropriate degree of protection for consumers' is the first of the FCA's three operational objectives.

18. Which? welcomes the recognition from the FCA that they can 'help increase consumer confidence in pensions' which is 'likely to encourage participation in pensions more generally.' The FCA's review of retirement incomes found that 52% of the fully withdrawn pots were were transferred into other savings or investments and that withdrawals were partly driven by 'a general mistrust in pensions that was typically based on perception of the sector rather than personal experience'.[9] Which?'s Consumer Insight tracker found that only 27% of consumers trust longer-term financial products.[10]

19. Both regulators must recognise that getting saving off to a good start will be improved as a result of a transparent and trusted regulatory environment. This will require a joint effort from regulators to ensure robust regulation and standardised disclosure of information in an accessible, understandable and personalised format.

Making sure pensions are well run and funded: effective governance and secure funding

20. Which? agrees that all types of savings vehicles should have effective governance processes to ensure members' money is safe and well managed. The call for input further notes that 'for DC schemes, key governance activities for trustees are having appropriate defaults for members who are not yet engaging with or taking action on their pension choices.'[11] Consumers opted into a workplace DC scheme as a default are unlikely to be given a choice of schemes. Therefore, the key activity of trustees (and IGCs) should not be limited to having 'appropriate' defaults but should be primarily achieving value for money and being effective in creating a competitive marketplace for pensions on behalf of consumers.

21. Effective governance is key for achieving value for money and regulators should ensure that governance regulations and standards are delivering equally for all schemes, particularly for default DC schemes. As consumers on default schemes will have no choice as to whether they are enrolled onto a trust or contract-based scheme, it is reasonable to expect the same standards of governance across all default DC schemes.

22. As stated earlier, Which? believes TPR and the FCA should jointly review the functioning of both Trustees and IGCs for default workplace pensions and consult on how best to ensure that any difference in governance result in fair outcomes and value for money for consumers. A review should determine how the impact of differing regulation, guidance and practices between IGCs and Trustees can be limited. The review should also consider whether TPR and the FCA are providing effective support to trustees and IGCs to ensure standards of governance continue to improve.

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[9] https://www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report.pdf
[10] https://consumerinsight.which.co.uk/tracker/compare/trust
[11] TPR and FCA, *Regulating the pensions and retirement income sector: Our strategic approach*, March 2018, Para 3.26

23. The call for a review takes into account the decision of the FCA to ‘indefinitely delay’ a review of the effectiveness of IGCs, especially given the ShareAction policy report, Who Watches the Watchers? Transparency and Accountability in Workplace Personal Pensions, found ‘more than a third of [IGC] reports we looked at did not state how much providers are now charging’ and that ‘no IGC is consistently reporting well’ on the quality of the scheme, including issues such as investment strategy, scheme administration, member communications and governance. The Pensions Charges Survey has shown that members in contract-based schemes pay more charges on average, 0.54% in 2016 compared to 0.48% for master trusts and 0.38% for trust-based schemes.

24. TPR and the FCA should regularly monitor the value for money achieved in both workplace personal and occupational trust-based pensions to ensure employees, who are not given a choice of scheme type, are not subject to unnecessary detriment.

Making sure pensions are safe

25. As pension pots grow, and the overall size of the market grows, it important that sufficient financial protections are in place to support consumers. The MoU between the two regulators states that ‘the FCA and TPR will liaise with each other as necessary on the compensation arrangements provided by the Financial Services Compensation Scheme (FSCS), the PPF and the Fraud Compensation Fund.’

26. While substantial protections are in place for consumers accumulating pensions, protections for consumers using pension freedoms to access drawdown products can have substantially less protection, with potentially only a £50,000 (set to rise to £85,000) maximum protection from the FSCS. Which? welcomes the planned increase in protections but has previously called for the level of protection on pension-related investments to be increased further.

27. While the proposed increase in maximum compensation for investment-based products will bring the compensation level above the 2016 average of £77,000 invested in drawdown products, it would have only provided cover between 74% and 85% of claims in the 2010-14 period.[12] The level set can be expected to provide proportionally less cover for consumers as pot sizes increase in the years to come and will potentially punish those who choose to consolidate their pension savings.
28. This position would seem to create a tension between the level of protection provided to consumers and the overarching aim of the regulators to provide greater trust in the market. Of the range of options proposed by the FCA, Which? supported increasing compensation levels for pensions drawdown products to £1 million. This would stand the test of time, and potentially increase awareness among consumers. Furthermore, according the the FCA this ‘would have provided virtually 100% protection in that [2010-14] period.’

[12] https://www.fca.org.uk/publication/consultation/cp16-42.pdf

29. Financial protection limits for pension investments should be constantly reviewed, with input from both the FCA and TPR, and should be subsequently increased to reflect the expected increasing value of pension pots.

Making sure pensions offer good value for money

30. Which? supported a number of measures to help ensure consumers are receiving value for money, including the introduction of a charges cap for default auto-enrollment schemes and the improved transparency on costs and charges. However, in both these areas Which? continues to support greater protection for consumers than has currently been achieved.

31. The Office of Fair Trading's finding that there is 'little evidence that firms compete on the basis of price' and 'no clear link between price and performance' in the DC pension market[13] is supported by the FCA's Asset Management Market Study which found 'weak price competition in a number of areas of the asset management industry' and that 'firms do not typically compete on price.'[14] If consumers can not effectively engage in the market in order to drive price competition it is essential, even with good governance schemes put in place to help, that regulators provide the 'appropriate degree of protection for consumers' and 'protect the benefits of members.'

32. Which? has called for a reduction in the cap on annual charges for default auto-enrolment pension schemes to 0.5%, or lower, of a member's funds under management, including transaction costs. 97% of members in master trusts, 85% of members in trust-based schemes and 41% of those in qualifying contract-based schemes incur an ongoing charge of 0.5% or lower, though there is disparity across schemes types it highlights that a significant number of providers already be compliant with a lower cap.[15] The cost of investing has fallen significantly since the introduction of current 0.75% cap – partly as a result of increasingly competitive low cost passive asset management[16] – and such reductions have only been partly passed on to auto-enrolment schemes due to weak competitive pressure on providers. Given the FCA and TPR have accepted the principal of a cap it is important that it is set at a level that will ensure competitive charges for consumers.

33. It is also worth considering that, though workplace pension schemes may have charges within the current annual 0.75% charge cap, once the transaction costs are included many consumers will be experiencing significantly higher costs. These costs are not made fully transparent to consumers and can have a significant impact on the returns to a consumer over a lifetime of saving.

[13] Office of Fair Trading (2013), Defined contribution workplace pension market study, p.116
[14] FCA, Asset Management Market Study Final Report (2017)
[15] TPR, Pension Charges Survey 2016: Charges in defined contribution pension schemes (2017), Table 3.3
[16] The FCA Asset Management Market Study found that average passive equity fund fee available to UK investors is 0.15% of the assets under management, compared to the average actively managed fund fee of 0.90%.

34. Which? recognises regulators are limited in how they can act. In the case of costs and charges the FCA and TPR should work with stakeholders, including consumer groups, to determine whether the cap can be lowered to protect consumers and, as new information is disclosed, review the impact of transaction cost. Any review of the cap should determine whether it should be benchmarked against more competitive market products, such as SIPPs or ISAs, and who should be responsible for setting it. The FCA and TPR should use their expert knowledge and help push for change from Government or, if appropriate, push for changes to the statutory powers of the relevant regulators.

35. Transaction costs and charges are one of the largest sources of detriment to consumers. Transparency and understanding of this issue by IGCs and Trustees is key to ensuring judgements can be made at a scheme level about value for money. Reporting on costs to consumers is vital as they ultimately bear these costs. Only by reporting all scheme costs both publicly and to consumers can trustees and IGCs be held to account about their value for money judgements.

36. Which? has called for greater standardisation in the reporting of all costs and charges than that achieved by the combination of the Pension Schemes (Disclosure of Transaction Costs and Administration Charges) Instruments 2017 and the Occupational Pension Schemes (Administration and Disclosure) (Amendment) Regulations 2018. In particular, the pensions scheme disclosure instruments do not provide for a fully standardised disclosure of costs; there remains significant flexibility on how illustrations are designed and flexibility about what information is provided alongside it; firms have not been prohibited from referencing historical investments, and: the new illustrations are not being included in the annual benefit statement.

37. Part of the challenge of reporting data to consumers is that there remains flexibility in how information is reported to trustees and IGCs. Calculations for costs and charges should be standardised and reflect all investment costs and these costs should be disclosed in a standardised way to trustees and IGCs of workplace pensions.

38. The Investment Disclosure Working Group set up by the FCA to look at how costs and charges should be disclosed is welcome. The FCA should ensure progress is made on standardised disclosures of costs and charges to all DC schemes as well as DB schemes. The FCA should work with the TPR to ensure that trustees of occupational schemes can properly use this information to judge value for money.

Supporting good choices and outcomes for consumers and members

39. Where consumers have the ability to make choices in the pensions and retirement income sector it is essential they are supported by appropriate advice, guidance and information in order to be able to make good choices. Where consumers are not making choices it is essential that appropriate regulation is in place to protect consumers.

40. Which? welcomes the recognition that consumers need to ‘be supported by appropriate, reliable advice or information, available at the right times’, however, notes that the FCA and TPR have not provided any focus on good choices during

accumulation stages. Consumers should be supported to make good choices throughout the lifetime of their savings, as choices during accumulation, including changing their contribution levels and consolidating their pension pots, can have a significant impact on outcomes.

41. A key tool in providing appropriate support for pension savers will be the pensions dashboard. The FCA and TPR must proactively work with stakeholders to ensure that they are providing the expertise and the necessary regulatory support for the development of a comprehensive dashboard which allows consumers to access all relevant information about all pensions pots, as well as use the information to make decisions about accumulation and moving and consolidating pots. For the dashboard to be effective all appropriate information must be provided in a clear and standardised format and should include clear details on costs.

42. An increasing number of people will be accessing funds saved through DC schemes, and from an increasing number of pots. The potential for detriment in pensions decumulation will be increasingly present in a market where consumers have not had to actively engage and where the total value of pensions savings is increasing. There are concerns that consumers are not aware of the impact of inaction (e.g. cash ‘defaults’ which result in savings declining in real value) and are unaware of the impact of costs and charges on the various decumulation options. As a result consumers may make choices that are not fully informed.

43. For consumers that are not seeking advice or making decisions, Which? has called for the FCA to introduce default income drawdown investments and an associated charge cap for the least engaged consumers. The FCA should benchmark the charge cap against the most competitive pensions products in the market. To achieve this the FCA and TPR should work with Government and stakeholders to develop the necessary regulatory framework. They are in a unique position to fully analyse the level of total charges that different groups of consumers are currently paying assess how charges relate to providers’ costs.

44. It terms of supporting engaged consumers to make good choices in decumulation Which? has called for the FCA to develop and mandate summary cost metrics and to encourage comparison tools for income drawdown. This will help consumers to shop around, and promote competition.

45. Which? also supports efforts to increase engagement and support through the pensions dashboard. Crucially, the pensions dashboard needs to enable consumers to compare the value for money of their pension products, consolidate their pension pots, and switch providers.

46. Both regulators should also use appropriate channels to encourage increased take-up of the Pension Wise guidance service, including potentially via a ‘default’ offer of guidance for non-advised consumers that request access to a pension pot. The service also needs to have a stronger focus on improving consumer outcomes, with regular monitoring and evaluation.

47. Which? is concerned about the number of consumers transferring out of DB schemes. It is an action that sees the consumer take on all the risk in relation to their pensions savings as they are giving up a guaranteed retirement income. The FCA found in 2017 that only 47% of advice they reviewed on DB to DC transfers could be shown to be suitable.[17] The FCA and TPR should continue to review whether appropriate advice and guidance is being given to consumers and whether there is appropriate regulation in place to protect consumers.

Emerging risks and opportunities

48. Which? believes the macro trends identified, including market volatility, changes to interest rates, changing demographics, pressures on household finances, advances in technology and labour market changes, are those likely to drive change across the sector. It is also important that TPR and the FCA monitor the changes in the value, type and average number of pension pots held by consumers. The shift to DC pensions and the introduction of auto-enrollment will see significantly more consumers having to make active choices about how to take a retirement income. This and the increased levels of savings means that poor choices by consumers will have potential to cause greater harm. Robust regulation must be developed to reflect the potential harms and risks in the current landscape. As we have set out above, this could include regulated 'default' decumulation options and a charge cap for drawdown products, to help protect against the emerging risks as a result of the changes in pension saving.

49. Both emerging risks and opportunities exist as a result of a provision for the introduction of Collective Defined Contribution (CDC) pensions into the UK regulatory framework. CDC pensions are a much more complex product that a standard DC pension and could significantly change the pension landscape in the near future. Though they might reduce volatility of outcomes and help create more certainty around retirement incomes, strong governance will be crucial if CDCs are to avoid some of the past issues with similar products which have aimed to smooth returns, such as with-profit funds.[18] The FCA and TPR should work with stakeholders to ensure that, if CDCs are introduced to the UK market, the appropriate protections are in place for consumers.

50. One of the most effective ways regulators can protect the industry against market volatility and changes in the economy is clear and transparent regulation. This will help increase consumer trust and confidence in the market. This is 'likely to encourage participation in pensions more generally' and will help support continued participation throughout periods of market volatility.

About Which?

Which? is the largest consumer organisation in the UK with over one million members and supporters. We operate as an independent, apolitical, social enterprise working for all consumers and funded solely by our commercial ventures. We receive no Government money,

[17] https://www.fca.org.uk/publications/policy-statements/ps18-6-advising-pension-transfers
[18] https://www.fca.org.uk/publication/archive/fsa-with-profits-report.pdf

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.

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