THE
INVESTMENT
ASSOCIATION
INVESTMENT MATTERS

Caroline Donellan
Strategy and Competition Division
Financial Conduct Authority
25 The North Colonnade
London E14 5HS

The Investment Association
Camomile Court, 23 Camomile Street,
London, EC3A 7LL

T +44 20 7831 0898
E enquiries@theia.org
W theinvestmentassociation.org
Twitter @InvAssoc

Date: 27 April 2018

Dear Caroline,

RE: FCA DP18/1 – Effective competition in non-workplace pensions

The Investment Association[1] welcomes the opportunity to provide input to the FCA's discussion paper on effective competition in the non-workplace pensions market. Our members generally do not provide pension products directly, whether workplace or non-workplace. However, they are a critical component in the pensions value chain and investment management is an increasingly visible part of the new pensions landscape. We contribute to this consultation on that basis, offering a number of general comments about competition and customer-focused delivery.

The new pension landscape

We have three over-arching comments about the nature of this landscape and regulatory activity.

1. <u>The importance of the investment process</u>

DC pensions, whether workplace or non-workplace, are effectively a very long-term investment engine within a tax wrapper. In drawdown, this investment engine will continue to operate into retirement. We recognise that direct investment risk sits with members in a

---

[1] The Investment Association is the trade body that represents UK investment managers, whose 240 members collectively manage over £6.9 trillion on behalf of clients.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs.

The UK is the second largest investment management centre in the world and manages 36% of European assets.

More information can be viewed on our website.

way that is very different from the DB or with-profits landscape of the 1980s and 1990s. It is also distinct from an annuity in retirement. This is a key common feature between workplace and non-workplace pensions.

One particular feature of the debate about quality and customer outcomes in the DC workplace market has been an emphasis on overall cost, rather than overall value, particularly with respect to the importance of investment processes. **We would encourage the FCA to acknowledge more clearly the role of appropriate investment decisions** in the delivery of good customer outcomes. This holds true regardless of whether the customer is in a workplace or non-workplace pension. We comment further on charges in point 3 below.

While we agree that the decisions facing customers over very long term savings horizons can be complex, we do not agree that the investment processes to deliver long-term returns are inherently complex. This is particularly the case in a market which is overwhelmingly characterised by unit-linked investment funds (whether insurance delivered or directly through unit trusts and OEICs). With reference to comparisons made in the DP (Para 3.2), what distinguishes an individual stakeholder pension from any other pension is not an inherent simplicity of underlying delivery. It is a certain level of control over two key criteria: charges and the need for a default arrangement. This brings it closer, as the paper notes, to DC workplace arrangements.

To the extent that modern pension products charge on a similar basis to asset management products (an ad valorem charge levied on the investor's assets with limited use of entry and exit fees), we would also be cautious about using the term 'complex' in relation to charging structures. That said, we note the legacy issues identified by regulators and recognise the importance of addressing these. We also fully recognise and support the need to ensure that there is full transparency and consistency in the information available and accountability for both product charges and underlying transaction costs incurred in delivering investment returns. The IA and asset management industry are currently working to deliver that consistency and transparency across both retail and institutional customer markets.

2. <u>Implications for decision-making in different markets</u>

As the DP notes, there are a number of conditions that distinguish workplace pensions from non-workplace pensions, notably in the circumstances under which scheme selection and ongoing monitoring takes place. The IA does not believe that charge caps are an optimal policy tool, sharing the view of the OFT that they can have unintended consequences. We also broadly support the conclusion of the OFT that a combination of behavioural issues for both employers and employees in the context of scheme selection and monitoring (including barriers to switching) justifies an additional governance protection in the workplace market.

For non-advised customers, despite a clearer connection between individual decision and selection/switching of provider, we agree that some of the lessons of the workplace pensions market are likely to be relevant. Customers may find decision-making and ongoing engagement challenging and there are a number of mechanisms that can help to simplify that process.

We suggest that a common set of principles could be applied across the workplace and non-advised pensions market. These could include the presence of a default arrangement; strong investment governance; transparency of delivery on performance against objectives; and full disclosure of costs and charges. Such principles are being introduced in the context of the third pillar Personal European Personal Pension (PEPP) and the IA supports the overall approach in the EC legislative proposal. The current EU legislative debate illustrates the importance of getting the balance right between flexibility of product design to encourage competition and innovation, and customer protection. Excessive prescription in terms of charge structures and/or investment process may inhibit a flourishing market.

We make a critical distinction here between advised and non-advised investors such that in the advised market the presence of the adviser, particularly where employed on an on-going basis, means the regulatory architecture of the workplace market is much less relevant.

In this regard, we would encourage the FCA to consider the different customer protection elements across the market in the context also of recent reforms and ongoing regulatory activity, notably the Asset Management Market Study and the Investment Platforms Market Study. An advised customer could in future access the retirement savings market and buy funds that will have an additional value assessment provided by the product manufacturer. It is not clear to us that adding an additional level of governance is justified without evidence of customer harm in the advised market.

3. Charges and scheme quality

The level of charges clearly have an impact on the customer's outcome and competition needs to function effectively. However, while charges are important, **the main determinants of good customer outcomes in a pension product are the level of contributions, the quality of scheme and investment governance/advice received (as applicable) and the resulting investment returns achieved**. In that regard, focusing on the level of contributions is important and we welcome the FCA's focus in its 2018/19 Business Plan on savings adequacy and the extent to which consumers are under saving for retirement.

The key lesson to draw on charges from the workplace pensions market is that in some parts of the market, quality has been conflated with low cost[2], a possible impact of the charge cap, which seems to have incentivised some workplace pension providers to compete purely on price. The drive to lower costs has been partly responsible for default investment strategies that are designed to minimise costs rather than being designed with the objective of getting the member the best possible outcome for a given investment budget. The risk here is that customers end up with products that are cheap but that may not necessarily deliver them optimal outcomes.

For example, while index returns can be accessed at very low cost, some approaches to managing risk (including through diversification) will be more expensive but may be precluded from investment strategies if price is seen as the main point of competition by consumers and product providers. This lesson should be reflected in the discussion about charges and quality of delivery in the non-workplace pensions market.

A necessary precondition for a well-functioning market is clear and transparent disclosure of product charges and transaction costs on underlying investments to customers. We note that the FCA is due to publish a consultation later this year on disclosure of costs and charges to contract-based workplace pension scheme members and suggest that the same standards should apply in the non-workplace pensions market. There should be clear

[2] See the IA's response to the DWP's 2017 Review of Automatic Enrolment. Our response sets out some evidence on charges in the workplace pensions market and discusses the impact of the charge cap on DC default strategy design.

disclosure of product charges and transaction costs on the underlying investments, with the latter contextualised with the performance delivered.

DC pensions and the retirement income market

The retirement income market is where workplace and non-workplace pensions merge, and the post-2015 market is still taking shape. We encourage the FCA to consider the Retirement Outcomes Review alongside this Discussion Paper, given the heavy overlap of issue areas.

We agree with regulators that retirement income decisions can be challenging, particularly where there is no formal advice taken. However, we have already noted in our response to the FCA Retirement Outcomes Review[3] that customer engagement is going to be necessary in this market and policy tools based on inertia cannot be relied upon to the same extent as they are in the savings phase. This is primarily because it involves policymakers and regulators making a choice on behalf of individuals about which method of accessing a DC pension is best for them. Such a decision is difficult to execute, not least because done properly, it would involve taking into account overall wealth, both pensions (state and private) and non-pension.

Our view is that some form of customer engagement is essential, both with respect to the overall direction taken (to annuitise or not; to go into drawdown; to take cash; to do a combination of these things) and, for drawdown, even after a product has been purchased.

Where a customer is non-advised, there is a strong case for pathways that mean that once they have decided how to take retirement income, a type of default is available, although some ongoing engagement will still be required. For example, having chosen drawdown, the customer will need to engage on the timing and amounts of withdrawals but the construction and ongoing governance of the investment strategy is undertaken on behalf of the customer.

The principles behind the construction of such default arrangements in the drawdown landscape should be similar to those outlined above. Clearly, cost is an important factor, but value will largely be determined by clarity of overall objective combined by delivery of a sustainable income flow through retirement.

We hope this response is helpful and we would be happy discuss it with you further.

Yours sincerely,

Jonathan Lipkin

Director – Policy, Strategy & Research

Imran Razvi

Public Policy Adviser

[3] IA response to the FCA Retirement Outcomes Review Interim Report.