PENSIONS AND LIFETIME SAVINGS ASSOCIATION

HOT TOPIC SEMINAR

Pensions: The new risk landscape for DB and DC

Seminar sponsored by:

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Safeguarding the consumer in the new risk environment

Sue Lewis

Financial Services Consumer Panel

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The Bad Old Days?

Risks to consumers:

Accumulation

- Saving too little, too late
- Poor investment choices/inappropriate default
- Costs and charges reducing size of pension pot

Decumulation

- Uncompetitive annuities market
- ‘Non-advised’ sales
- Buying the wrong annuity
- Buying a poor value annuity

The Brave New World

Risks to consumers:

Accumulation

- Saving too little, too late
- Poor investment choices/inappropriate default
- Costs and charges reducing size of pension pot

Decumulation

- Longevity
- Buying a poor value product
- Costs and charges reduce income
- Scams

Too little, too late

- 5.4 million workers automatically enrolled (as at end August), 9-12 million by 2018 (NAO 2014)

BUT:

- 8% is not likely to be enough (PPI 2013)
- Many are excluded
  - 5.2 million ineligible (low pay or age) (NAO 2014)
  - 4.5 million self-employed
- Some opt out, around 10% (DWP 2014)

Defaults

- Increasingly important – 99% of master trust members in default funds; 85% members other workplace DC schemes (PPI)
- More difficult to manage with pensions freedoms
  - No set retirement date
  - No automatic conversion to an annuity

Investment costs and charges

- 0.5% annual charge reduces pension pot by 13%; 1% by 24% (DWP, 2013)
- “The reporting of product charges is typically neither clear nor consistent” (Sandler, 2002)
- Firms too frequently provide information on fund charges that is “unclear, insufficiently comprehensive and misleading” (FCA, 2014)
- Few firms exercise effective control over costs deducted directly from the fund (FCA, 2012)
- Railpen Investments found headline fees were around a fifth of total costs (*Professional Pensions*, 2014)
- Employers are unaware of charges paid by employees (DWP, 2014)

Pensions Freedoms

The first six months (ABI 2015):

- £2.5 billion cash, average £15,000
- £2.2 billion income drawdown, average £3,600
- £2.85 billion invested in income drawdown products, average £65,000
- £2.17 billion in annuities, average £53,300

Risks and problems

- Complex and confusing options
- Lack of awareness of advice/guidance options
- Cashing in – impact on tax and benefits, demands from creditors
- Running down fund too quickly or too slowly
- Failure to shop around (ABI):
  - 40% buying an annuity
  - 60% buying an income drawdown product
- Implications of buying retirement income products through 'non-advice'
  - Opaque charges, commissions
- Unexpected exit fees – 11% schemes charge a fee (FCA)
- Scams – fake Pension Wise 'lookalikes', fraud, unregulated investments

Regulatory Framework: Trust vs Contract Based (PPI)

	Contract-based (FCA) – rigorous and preventative	Trust-based (TPR) – pragmatic and flexible
Approach	Optimises individual outcomes	Optimises collective outcomes
Rigour of regulatory regime	Threshold conditions, authorisation, supervision, thematic reviews	Reliant on trustees and other professionals to report breaches, statutory whistleblowing duties
Communication with members	Prescriptive requirements	Schemes able to tailor communications
Compatibility with workplace pensions	Requirement to promote consumer choice not well suited to auto enrolment	Schemes have leeway to provide information relevant to the members' situation
Cost	Compliance costs high	Less work and trustees have freedom to make decisions if judged beneficial to the member

Pensions Freedoms – Protecting Consumers

- Advice and guidance
  - ‘Second line of defence’ – risk warnings to members wishing to withdraw pension savings
  - Pension Wise ‘guidance guarantee’
  - DB to DC – compulsory regulated advice
- Master Trust Assurance Framework
  - Voluntary
  - Four (large) members: NEST, NOW: Pensions, SEI Master Trust and The People’s Pension
  - Charge cap of 0.75% for GPPs and trust-based schemes used for auto enrolment defaults
  - New requirements on trustees, including consideration of value for money
- Independent Governance Committees
- Scorpion (TPR); ScamSmart (FCA)

Some remaining issues

- Pension freedoms – no systematic evaluation of benefits
- Pension Wise
  - Low take up
  - Pressure to use pension providers' 'in house' guidance
  - Not holistic
- Advice 'gap'
- Non-advised sales of retirement income products
- Master Trusts
  - Low entry requirements - poor value for money, potential costs of exit
- Unregulated advice to employers
- Problems in assessing value for money

Better Consumer Protection – a Wish List

- Financial Advice Market Review/Public Financial Guidance
  - Solution for ‘small pots’
  - More efficient regulated advice
  - Adequate consumer protection for ‘robo advice’
  - Code of conduct for ‘non-advised’ sales
  - Holistic Pension Wise, evaluation of outcomes
  - Simpler and more transparent information on the costs of drawdown and UFPLS
- Asset management
  - Trustee and IGC pressure for cost transparency
- FCA regulation of advice to employers and Master Trusts
- Better information – Pensions Dashboard

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