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

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10 November 2022

By email: pensionsdashboard@dwp.gov.uk

Dear Sir / Madam,

Financial Services Consumer Panel response to DWP's consultation on broadening the investment opportunities of defined contribution pension schemes

The Financial Services Consumer Panel (the Panel) is an independent statutory body. We represent the interests of individual and small business consumers in the development of policy and regulation of financial services in the UK. The emphasis of our work is on activities that are regulated by the FCA, however we also look at the impact on consumers of activities that are not directly within but are still relevant to the operation of the FCA's rules and monitoring activities in the pensions sector.

In general, the Panel considers it is important that the overarching regulatory regime governing retail investments, including financial promotion rules (with reference to disclosure requirements) provides a coherent approach to setting regulation that meets consumers' needs. Our response should be considered in the context of our vision for how the market should function, which is set out in our response to the FCA's call for input on consumer investments. The foundation of this vision is a correctly implemented and supervised Consumer Duty[1]. This would make the firm responsible for the appropriate distribution of high-risk investments including the marketing, labelling and comparability of different investment options, as well as consumers' overall suitability for and understanding of the products which they invest in.

The Panel welcomes the opportunity to respond to the Government's consultation on broadening the investment opportunities of defined contribution pension schemes. Whilst not all the questions are applicable to the Panel, we have responded to those of most relevance. In general, the Panel is supportive of the proposals that will strengthen disclosure requirements, as these will help boost transparency. The Panel is concerned, however, about proposals to exclude performance related fees from the charge cap. You can find in Annex A below the Panel's response to the questions we believe of relevance.

Yours sincerely,

Helen Charlton

Chair, Financial Services Consumer Panel

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[1] For our comments on the FCA's proposed new Consumer Duty, please see here: https://www.fs-cp.org.uk/sites/default/files/final_fscp_response_cp21-36_a_new_consumer_duty_20220214.pdf

Annex A - Questions

Question 1 – Do you have any comments on the draft regulations in relation to the disclose and explain provisions? Please include in your answer any comments on whether you consider they meet the stated policy intent.?

The Panel agree with DWP that it is important that members have access to all relevant information surrounding the investments being made using their contributions and the outcomes these investments could have on their future retirement funds. It also agrees that it is important that such disclosures should be made in a way that will be easy for consumers to understand. The Panel therefore supports the proposal that disclosure requirements should relate to asset types, rather than funds, and should be made at a relatively high level of granularity. The Panel also supports the proposal that there should not be any asset under management threshold associated with disclosure requirements, so that all schemes are required to provide effective disclosure. The Panel considers that it is important to ensure that there is a strong focus on consumer protection that is backed by clear, concise, easy-to-understand disclosure.

The Panel supports proposals that schemes should provide specific disclosures to members when they reach 25, 45 and 55, as well as the additional proposal of disclosures to be made at one day prior to the State Pension Age. Such disclosures have the potential to help prompt members to think about the decisions that they need to make, and it will be important that they are designed with this in mind.

Question 6 – Do you have any comments on the draft regulations in relation to the performance fee measures?

The Panel are very concerned about the proposal to exclude performance related fees from the charge cap. Historically, one of the biggest determinants of investment returns for retail investors has been fees, meaning the charge cap is a powerful tool for boosting returns for investors, by forcing the investment industry to improve its efficiency in order to compete. Excluding performance fees from the charge cap will considerably weaken the incentives for asset managers and investment professionals to reduce fees, which will be to the detriment of pension holders.

The Panel are also concerned that the performance fees that are allowed outside the charge cap may relate to nominal returns, rather than risk-adjusted returns. The Panel notes that investments such as long-term asset funds (LTAFs) are highly illiquid and high-risk investments. As such, allowing performance fees to be charged on nominal returns may simply reflect the fact that the pension scheme has taken on more risk, rather than that any returns are genuinely superior when judged on a risk-adjusted basis. The Panel therefore considers that any exclusion of performance related fees from the charge cap should only be possible where they relate to superior risk-adjusted performance.

This is particularly important as the assumption that investments in illiquid assets such as infrastructure will deliver superior returns may not always hold. The assumption would have been derived over a period of low interest rates. However, the risks associated with such investments will not necessarily be stable. For example, the recent shift to a high inflation, rising interest rate environment may impact the viability of some of the underlying investments permitted.

Furthermore, even though the current proposals include proposals to increase the disclosure requirements associated with performance related fees, understanding the risks associated with individual investments may be challenging for retail investors. This makes it important that effective protection is in place. It is also important that trustees ensure they act in the best interest of scheme members. For example, it is important that trustees consider issues such as the age profile of the scheme, before investing in infrastructure.

For example, it is highly unlikely that illiquid investments would be suitable for schemes where most members are close to retirement.