PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

DISCLOSURE OF COSTS, CHARGES AND INVESTMENTS IN DEFINED CONTRIBUTION OCCUPATIONAL PENSION SCHEMES

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TIM GOSLING, POLICY LEAD: DC

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INTRODUCTION

The Association is very pleased to respond to this consultation. We believe that the measures proposed by the DWP will lead, over time, to a significant and sustained improvement in the value for money achieved by pension schemes and by members. We believe that it should be a simple condition of doing business that members should be able to see how much they are paying for investment services. There are no good reasons for not disclosing costs and charges to members in a clear format.

The Association takes the issue of transaction costs seriously. Our members, both in the DC and DB spaces have led attempts to uncover and evaluate the role costs play in the value for money equation. As such, we have participated in both the Investment Association's working groups on charges and also in the initiatives run by the FCA, including the Institutional Disclosure Working Group (IDWG).

More generally, the PLSA takes the issue of charges seriously, as do the Association's members. The median charge in the PLSA membership is 40 basis points and the PQM standard's charge cap pre-dates the introduction of a charge cap on default funds used for automatic enrolment.

This is part of an overall organisational focus on value for money. In 2015 we published a guide to value for money for trustees in order to help them better understand their new "value for members" duties. In 2018 we will bring forward further proposals for value for money metrics as part of our "Hitting the Target" consultation. This consultation remains open until 12 January. More broadly, cost transparency across all parts of the investment chain will be a key focus of our policy work in 2018.

There is, though, a discussion to be had about how information about costs and charges is framed and what members will see first. Price is an important component of value for money but cheap does not always equate to good. The industry has recently seen a shift towards thinking that passive funds may offer equivalent or better performance after charges than actively managed funds. But, passive management may not always be the most appropriate investment strategy for schemes and also may not be an option for some asset classes. If trustees think that members should be exposed to emerging market equities or to illiquid investments like property or infrastructure, then these will need to be actively managed. Some asset classes, including illiquids, will typically have a higher level of costs.

This means that disclosure of information about price should be part of a wider conversation with the member about value for money. Good quality disclosure will equip members to weigh costs and charges against other aspects of scheme performance. Too much focus on price may cause members to believe that cheaper but potentially lower quality funds are a good option. It may also cause members to think that poorer quality product choices, which are less transparently priced e.g. cash or investment ISAs might be better than a workplace pension. With the Association's average charges at 40 basis points, the prospect of members transferring out into much more expensive but less clearly priced products is a concern. We set out our views on value for money below and on what should be the ultimate purpose of disclosure.

COSTS, CHARGES AND VALUE FOR MONEY

Different ways of thinking about value for money

We believe that costs and charges are only one part of the overall assessment of value for money. We think that there are several different ways of thinking about value for money, each of which is valid and each of which might cause customers to think differently about price.

1. We can think of value for money as contributions, plus investment gain, minus costs and charges. This definition has its attractions as it is both simple and gets to the core of what matters most: the provision of assets to support an income in retirement. There are two issues with this approach:
    a. First, value is only really observed in retrospect. We can establish proxies for value by trying to judge the quality and appropriateness of inputs. There may be a weak or uncertain relationship between input quality and actual value.
    b. Pension saving is dynamic: for instance, communications, benefit structure and choice architecture can all affect how much individuals contribute. This sort of approach may not fully capture the value provided by good scheme design.
2. We can think more broadly and take in other important aspects of how a scheme is run: for instance the quality of administration and the impact of communications. The current value for members assessment attempts this but is limited by its scope.
3. We can think more broadly about the totality of the value provided by the scheme. That might include everything in the second definition and look also at elements excluded from the second definition, including parts of the scheme paid for by employers.

The question for policy makers and trustees is which of these to highlight when discussing value for money with scheme members. It feels to us that the basis for a conversation about value with scheme members should be either the second or the third definition, with the third being more complete.

The challenge is to render this information in a comprehensible and clear manner such that members can understand it and use it as the basis for a decision. The PLSA will undertake further work on this issue in 2018 as part of the "Hitting the Target" consultation.

What should our objectives be in disclosing information to members?

It is important to be clear about what our objectives are. Obviously we want to be transparent but we also want to encourage good quality decision making. We are also aware that how information is presented to individuals, in any context, not just pensions, may have a significant impact on the decision they take[1].

We believe that when schemes make information available, they should do so with the aim of enabling good decision making. The outcome we want here is for individuals to be able to identify a scheme that is good value for money and also feel confident saving into it. We think that means seeing information that includes material about costs and charges appropriately contextualised – as the consultation paper suggests. But it should also outline in a meaningful what those costs and charges buy.

We are keen that schemes are encouraged to further contextualise the disclosure requirements outlined in the consultation paper. We anticipate that over time this may evolve from adapting material in the Chair's statement to the use of value for money metrics. As noted earlier, the development of these metrics will be a priority for the Association in 2018.

[1] See for instance: Tversky A. and Kahneman D. "Judgement under uncertainty: heuristics and biases" Science, New Series, Vol. 185, No. 4157. (Sep. 27, 1974), pp. 1124-1131 http://psiexp.ss.uci.edu/research/teaching/Tversky_Kahneman_1974.pdf

CONSULTATION QUESTIONS

QO1. The proposed Regulations on costs and charges apply to the same schemes to which the existing requirements to assess charges and transaction costs and to prepare an annual governance statement applies currently. Do you agree with this proposal?

Yes. We believe that the scope of the measures is appropriate.

QO2. We propose that:

The Chair's Statement should be extended to include the actual charges and transaction costs for each default arrangement and any alternative fund choices.

Do you agree with this proposal?

Yes. We agree with this proposal. Disclosure of costs and charges is an essential step forward for occupational pension schemes. We believe that over time this sort of disclosure will lead to better value for money for scheme members.

QO3. We propose that cost and charge information should be:

(a) Published annually;

(b) The responsibility of the scheme trustees or managers to publish;

(c) At the discretion of trustees and managers of where to publish, as long as it is publically available and can be indexed by major search engines.

Do you agree with these proposals?

Yes. We note that there may be downsides to indexable search. We believe that this is more likely to expose investment managers to competitive pressure from each other than from members. The extent to which this approach is sensible depends on the extent to which increasing competition along that axis is a policy objective.

We have heard representations suggesting that this might result in lower costs and charges to members as a result of competitive pressure. We have also heard representations that those pricing differentially will respond to mandatory disclosure by levelling up their prices.

QO4. We recognise that how the information is contextualised and presented to members is important.

We therefore propose:

(a) that the 'default investment strategy' and 'Costs and charges and value for members' sections be published to provide appropriate contextualisation to the cost and charges information;

(b) that schemes are required to show the cumulative effect of costs and charges over time, as set out in the draft Statutory Guidance.

Do you agree with these proposals?

Yes. We believe that these proposals are sensible and will lead to better value for money for members over time. Our desire to disclose information to members is tempered by our awareness that the framing of the information may be as important as the content of the information. In our introduction, we argued that value for money in pensions needs to be seen in the round and not just reduced to a discussion about price. While price is important and costs and charges have a real impact on members' funds, an expert would not overweight price as a decision making criterion.

We believe that schemes should be encouraged to further contextualise disclosure with information about value for money. In the first instance, this could be taken from the Chair's statement. The PLSA will work further on value for money metrics in 2018 as part of our Hitting the Target consultation.

QO5. We propose that a web link to the location where cost and charge information for their pension scheme can be found is given to members as a matter of course when they receive an annual benefit statement. Do you agree with this proposal?

Yes. We understand that there has been extensive discussion of a standardised SMPI as part of the engagement strand of the 2017 review. The PLSA supports the work that has taken place on the standardised SMPI and we see this as an important step forward in connecting people to their pension savings.

While the placement of a link and associated text on the document might seem like a minor issue, it only takes a handful of additions to diminish the coherence of a document. That should be borne in mind when considering the future of a standardised statement.

QO6. Is any further guidance or support required to achieve to meet the proposed regulatory obligations in the proposed Statutory Guidance?

No. We do not believe further guidance is required.

QO7. Do you agree with the proposed penalty regime?

Yes. We note, though, that the information is extremely complex and that the timelines for its provision are short. Realistically, schemes will have difficulty with compliance in the very short term. We believe that the penalty regime should be applied with that in mind.

QO8. Do you agree with the proposal that trustees should only be required to provide a hard printed copy if it would be unreasonable for the individual to access the available information published online? Do you have any other evidence or thoughts about how these proposals will affect members of protected groups and what mitigations, if any, may be required?

Yes. This sort of approach is already standard practice with disclosure by master trust pension schemes that communicate with their memberships digitally.

QO9. Thinking about the current administrative processes undertaken by the scheme, can you give an indication of the additional time/costs of incorporating our proposals into existing process?

No response.

QO10. Do the draft Regulations deliver our policy intent, or are there aspects which you believe will not deliver our objectives? Do you foresee any unintended consequences?

Yes.

QO11. Are there any other proposals in this consultation on which you would like to offer comments?

No.

QO12. Do you believe that members, and recognised trade unions should have the right to request this information and that the requirement to disclose this on request is proportionate?

Yes. We do not believe, though, that members will make use of this facility.

QO13. Do you agree with the proposed timing and penalties for pooled fund disclosure on request? Do you agree with the policy that trustees should disclose the pooled funds invested in over the previous scheme year? If not, what alternatives would you propose?

Yes. We note, though, that the specifics of pooled fund disclosure may rapidly become out of date and are therefore of limited use.

QO14. Do you agree that restricting disclosure on request to only the pooled funds in which members were directly invested is more helpful to members and less burdensome to trustees?

Yes. We believe that this is a proportionate approach.

QO15. Do you agree with our proposed policy on disclosure of top-level pooled funds only, combined with 'look through' of unit-linked contracts and mandates to the 'first tier' of underlying pooled funds?

We are cautious about this policy initiative. Some members believe that to comply with this requirement would require divestment from high performing funds. In some cases, the nature of the component subfunds of a pooled fund and the exact asset allocation between those subfunds may be proprietary information of interest to competitors. Fund managers may refuse to hand over this information and thereby force divestment.

We are unsure as to the extent of this issue. We do not believe, though, that investment options should be, effectively, closed down by disclosure requirements.

QO16. Are there any circumstances where trustees and scheme managers would not be aware and would be unable to obtain information about the pooled funds in which their members are directly invested? If there are circumstances in which they are unaware, please clarify how trustees remain compliant with their fiduciary duties in these scenarios.

We are not aware of circumstances where this is the case.

QO17. Do you agree with our proposal that schemes should give standard information about the availability of further information about pension scheme investments in the annual benefit statement? Are there any reasons why this requirement would be burdensome or undesirable?

We are concerned that any future standardised annual benefit statement does not gradually acquire additional disclosure requirements and thereby become unwieldy and hard to read. Limiting disclosure to signposts to further information is probably the right way forward. The FCA has undertaken a significant level of investigation and analysis of this area as part of its Smarter Consumer Communications agenda and we believe there are useful learnings from their work in this area.

QO18. Thinking about the current administrative processes undertaken by the scheme, can you give an indication of the additional time/costs of incorporating our proposals into existing processes?

No response.

QO19. Are there any areas where the regulations do not meet the policy intent?

No.

QO20. Are there any other proposals in this consultation on which you would like to offer comments?

No.

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