European Commission consultation on consumer protection in third pillar retirement products

The NAPF's response

July 2013

Overview

The NAPF welcomes the European Commission's emphasis on strengthening consumer protection in personal pensions and is pleased to be able to respond to this consultation.

The UK's pensions landscape is being transformed by the introduction of auto-enrolment. Auto-enrolment will bring between 5 and 9 million new people into workplace pension saving. The vast majority of these new savers will be in defined contribution (DC) schemes, including Group Personal Pensions (GPPs). It is vital that these schemes are appropriately and proportionately regulated.

Much of this response hinges on the definition of third pillar retirement products. The NAPF's view is that the extent of employer involvement and control is the key factor that should be used to distinguish between second and third pillar pension schemes.

- Pillar 2 should cover all pension schemes used for auto-enrolment and / or where the employer makes contributions to the employee's fund and / or where employers provide some form of promised benefit.

- Pillar 3 should cover any type of private retirement product for accumulation of savings subscribed to by consumers on an individual basis.

This means that GPPs used for auto-enrolment would fall under Pillar 2, but GPPs where there is no employer engagement (for example, no employer contributions) would fall under Pillar 3.

More broadly, a number of institutions, both at UK and EU level, have begun to explore quality standards in pensions. In particular, the NAPF understands that the European Commission's Directorate General for the Internal Market and Services has asked EIOPA for advice on how to strengthen the single market in personal pensions. There should be close collaboration across the European Commission on this work. The Directorate General for Health and Consumers should co-ordinate closely with the Directorate-General on Employment and EIOPA to ensure consistency in EU policy-making on personal pensions.

About the NAPF

1. The National Association of Pension Funds is the UK's leading voice for workplace pensions. Our members operate almost 1,300 pension schemes. They provide retirement income for nearly 16 million people and have over €1 trillion of assets under management. NAPF members are major investors in the EU economy: the NAPF's *Annual Survey* shows that 9.9% of our members defined benefit schemes' investments in 2012 were in UK equities, with a further 4.6% in European equities.

2. The NAPF's membership also includes over 400 providers of essential advice and services to the pensions sector. This includes accounting firms, solicitors, fund managers, consultants and actuaries.

3. The NAPF is the largest member of PensionsEurope, the EU-wide federation for workplace pensions organisations. PensionsEurope is chaired by the NAPF's Chief Executive, Joanne Segars.

4. The NAPF contributes closely to the work of EIOPA, and a number of colleagues from the NAPF's members (both pension schemes and advisory organisations) are members of EIOPA's Occupational Pensions Stakeholder Group (OPSG).

Introduction

5. The Directorate General for Health and Consumers is right to consider consumer protection measures in third pillar retirement products. As people live longer, they must have access to trustworthy saving products to secure an adequate income in retirement.

Auto-enrolment in the UK and its impact on DC pensions

6. The UK is currently introducing a major pensions reform – automatic enrolment into workplace pensions. Auto-enrolment means that every employer will be obliged to enrol qualifying staff into a workplace pension scheme, with the individual worker having a right to opt out should they wish to do so. The system is being phased in, starting with the largest employers in October 2012 and reaching micro-businesses in 2017.

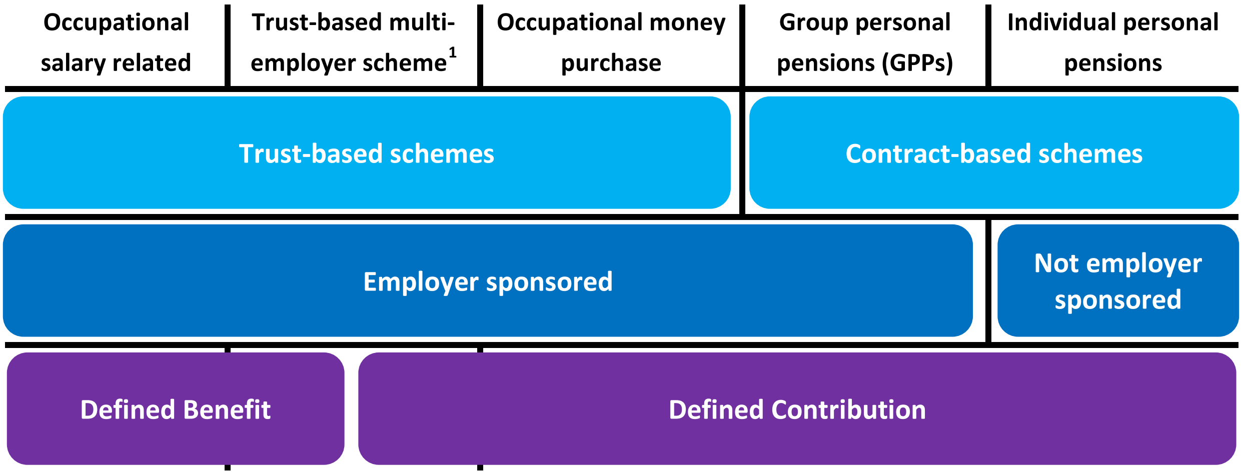
7. This important reform is expected to bring between 5 and 9 million extra people into workplace pension saving. The vast majority of these new savers will be in defined contribution (DC) schemes, including Group Personal Pensions, and the NAPF has been engaging with the UK Government to ensure that products used for automatic enrolment meet high standards.

Definition of pillar 2 and pillar 3 pensions

8. Although the NAPF principally represents providers and sponsors of workplace pensions, some products offered by the NAPF's members may fall under the current definition of third pillar retirement products.

9. The current definition of third pillar retirement products, as set out in the consultation document, has the potential to cause confusion in the UK pensions market. The UK has pensions products, including those used for automatic enrolment, which are established by the employer but take the form of a contract between the individual saver and a pension provider. These contract-based pension schemes, such as Group Personal Pensions (GPPs), may be included in the current definition of third pillar retirement products. Figure 1 below describe the UK's private pensions landscape.

Figure 1: Private pensions in the UK



10. The NAPF proposes a more nuanced definition of pillars 2 and 3:

- Pillar 2 should cover all pension schemes used for auto-enrolment and / or where the employer makes contributions to the employee's fund and / or where employers provide some form of promised benefit.

- Pillar 3 should cover any type of private retirement product for accumulation of savings subscribed to by consumers on an individual basis. Schemes used for auto-enrolment, or which benefit from additional employer contributions or where there is an employer promise regarding benefits would not be within Pillar 3.

11. This would mean that the regulatory framework would be determined not just by reference to whether the pension arrangement is set up through the workplace but by reference to the *extent* of employer

[1] The UK has many trust-based multi-employer schemes. Traditionally these have been confined to specific sectors and may provide either DC or DB benefits. More recently, a number of master trusts have entered the market. These generally provide DC benefits to a wide range of non-associated employers. Perhaps the best known of these schemes is the National Employment Savings Trust (NEST), but there are also others such as the People's Pension and NOW: Pensions.

control (for example, where the individuals' ability to transfer their pension is effectively limited since to do so would involve losing the employer's contributions).

The importance of good governance

12. There are up to 2.6 million active members of employer sponsored contract-based pension schemes in the UK, many of whom are contractually enrolled by employers.[2] The number will increase as millions of additional employees are automatically enrolled into pension schemes over the next few years. Savers enrolled into these workplace contract-based pension schemes will share many of the characteristics of those auto-enrolled into other types of pension scheme.

13. There is a risk that members are enrolled into a workplace contract-based pension scheme by their employer, and are then treated as though they are active consumers. However, these members are often unable to act as consumers since they may lose employer contributions if they change to a new pension provider. Experience in the UK also suggests that these scheme members may be poorly engaged with their pensions. As a result of automatic enrolment, many members of GPPs are being brought into pension saving through inertia rather than an active decision to save, making it even more important that good governance is in place to protect their interests.

14. It is important to note, however, that those auto-enrolled into a GPP face different kinds of risks than those auto-enrolled into trust-based schemes. Trust-based schemes have trustees with a fiduciary duty to uphold members' best interests. GPPs and other contract-based workplace schemes, have no equivalent of this duty. This means that, unless the employer takes an active interest in the scheme, there can be minimal governance. A governance vacuum can lead to poor member outcomes, for example when savings are left in sub-optimal investment strategies.

15. The result is that members of GPPs are exposed to different kinds of risk compared to savers who have an individual personal pension and savers in a trust-based workplace pension scheme. In order to get the best outcomes, GPPs and other workplace contract-based pension schemes should have strong governance arrangements that are able to monitor investments and provide considered default options to members who do not make investment decisions.

16. This means that, in a well governed GPP, there is little need for third pillar consumer protections. Where GPPs are poorly governed, the employer should consider moving to a multi-employer trust-based arrangement. In either case, regulation under the third pillar is not appropriate.

Industry initiatives to raise standards of pension provision

17. There are a number of initiatives in the UK to promote better quality pension schemes, including voluntary codes from both the Government and parts of the industry. Some of these, such as work undertaken by the NAPF and Association of British Insurers (ABI) aim to increase transparency around charges and in the annuities market. The European Commission may wish to incorporate the learning from these initiatives into any code that it produces for third pillar retirement products.

[2] The Pensions Regulator, *DC Trust*, January 2013

18. The NAPF's Pension Quality Mark (PQM) is a form of accreditation for good quality defined contribution (DC) workplace pension schemes. The PQM now covers 182 pension schemes with over 300,000 members. The PQM is available to schemes that pass standards on contributions, governance and communications. It is available to both trust-based and contract-based workplace pension schemes, including GPPs, though not to individual personal pensions. The NAPF would welcome a certification process for third pillar retirement products in principle, provided there is no overlap with the PQM's coverage of second pillar products.

Consistent regulation

19. It is important that regulators at all levels and across the European Union have a joined-up approach to regulating third pillar retirement products. The Directorate General for Health and Consumers should closely work with the Directorate General for Internal Market and Services and the European Insurance and Occupational Pensions Authority (EIOPA) which we understand is also considering regulation of third pillar retirement products.

20. The NAPF appreciates that different EU member states will be at different stages in the development of the regulatory regimes for third pillar retirement products, and the European Commission should look towards standardisation of those regimes. The UK, however, has a mature regulatory regime in place and compliance with different regimes (UK and EU) could be inefficient and create additional costs for savers. The European Commission should adopt a joined-up approach with national regulators including the UK's Department for Work and Pensions, HM Treasury, Financial Conduct Authority and the Pensions Regulator.

Questions

Definition of third pillar retirement products

1. Is the following definition, used in the 2012 questionnaire, effective for identifying third-pillar retirement products?

"Third-pillar retirement products are defined as any type of private retirement product subscribed to by consumers on an individual basis [as opposed to occupational], either voluntary or mandatory"

It would be helpful to clarify the scope of this definition. As discussed above, the UK pensions market includes contract-based pension schemes, such as Group Personal Pensions (GPPs), which take the form of individual contracts between scheme members and providers but are arranged by the employer. Members will save into these schemes as a result of their employer's actions. Often scheme members will have a limited capacity to act as a consumer. These products may also be used for automatic enrolment following recent reforms to workplace pensions in the UK.

It is also unclear whether the definition set out in the consultation paper refers to accumulation or decumulation products, or both. In the UK, decumulation products, such as annuities, are often provided by insurers to individual savers. They may, therefore, fall under the definition of third pillar products. However, an employer or the scheme's trustees may have procured the insurance provider on the individual's behalf. The NAPF also has concerns around the availability of advice and support to individuals who are approaching annuitisation. Ultimately, there are different requirements at retirement for savers depending on whether they have saved in an individually selected personal pension or workplace pensions as a result of arrangements made by their employer. For these reasons, it may be inappropriate to include all decumulation products under the third pillar.

2. If not, what would be the most appropriate common EU definition for third-pillar retirement products?

The NAPF recommends that this definition should be clarified. As we argue in the introduction above, the current definition of third pillar retirement products, as set out in the consultation document, has the potential to cause confusion in the UK pensions market.

The NAPF proposes a more nuanced definition of pillars 2 and 3:

- Pillar 2 should cover all pension schemes used for auto-enrolment and / or where the employer makes contributions to the employee's fund and / or where employers provide some form of promised benefit.

- Pillar 3 should cover any type of private retirement product for accumulation of savings subscribed to by consumers on an individual basis. Schemes used for auto-enrolment, or which benefit from additional employer contributions or where there is an employer promise regarding benefits would not be within Pillar 3.

This would mean that the regulatory framework would be determined not just by reference to whether the pension arrangements is set up through the workplace but by reference to the *extent* of employer control (for example in terms of limiting the ability of the individual to exercise their rights to transfer the pension).

A specific approach for third pillar retirement products

3. What are the main risks for consumers when purchasing a third-pillar retirement product?

In individual personal pensions, the risks are likely to focus on transparency and mobility. Consumers must be able to compare different providers' products. They must also be able to move their savings between different providers to get the best possible deal. Transferring between pension schemes in the UK can be inefficient and time-consuming. The NAPF is working with the UK Government and other industry bodies to improve transfer processes.

There are very different risks In workplace contract-based pensions, such as GPPs. These risks centre around inertia, where individuals who have not made an active decision to save may not engage fully with their savings. This is why good governance should be provided to ensure that savers get the best possible outcomes.

4. How problematic do you consider the asymmetry between the consumer and the provider in terms of information about and knowledge of third-pillar retirement products?

The starting point on this issue should be a recognition that personal pensions are used by several different types of savers – each with different levels of financial literacy and, therefore, with different requirements in terms of consumer protection. These groups include:

- self-employed workers with no access to conventional workplace saving. In general, they will be relatively poorly informed about pension products and would benefit from guidance and protection.

- members of Group Personal Pensions, who will have been enrolled into the scheme by their employer. These savers are likely to be relatively poorly engaged with the detail of their pension arrangements and are not well placed to take decisions on fund choice or annuity purchase without extensive advice.

- sophisticated savers with experience of making their own saving and investment decisions. These savers take a high level of responsibility for their own financial arrangements and may relish the opportunity to use a Self-Invested Personal Pension (SIPP) for part of their retirement planning. Clearly they have less need for advice and protection.

Clearly the first two groups would gain the most from improved governance and guidance. The latter group of savers consist of individuals who are are clearly content to take a high degree of personal responsibility for their own financial decision-making, and there is much less of a case for extra governance in their case.

Improved governance for the first two groups should include measures to strengthen transparency over costs. The NAPF has made considerable progress in gaining greater transparency of charges through the Joint Industry Code of Conduct on Charges, which sets out a framework for providers of workplace schemes to disclose charges to employers. We support the ABI's work to extend that transparency to scheme members.

5. Are there specific needs of consumers purchasing third-pillar retirement products that have to be better taken into account, for example via EU voluntary codes or certification schemes on consumer information (transparency) and protection standards?

- **If so, how could consumer information (transparency) be improved? Please cover precontractual and contractual information**
- **If so, how could protection standards be improved? Please cover marketing, sales practices, inducements, advice and other aspects.**

Savers need to have a good understanding of the value for money offered by different providers; how much they pay and what service they are offered in return.

Instruments: self-regulatory code or EU certification scheme

6. Would a self-regulatory code be the best tool for improving the quality of third-pillar retirement products?

Provided that such a code applies only to individual personal pensions, and that employer sponsored personal pensions are regulated under the second pillar, the NAPF has no view on this issue.

However, our involvement in the design and introduction of voluntary codes in the workplace pensions area has underlined for us the importance of taking the right decisions on how codes of practice are monitored and enforced. It is very important to be clear about which body has responsibility for any such code and about the powers available to promote the code or require compliance with it.

7. For which objectives would it be the best way of doing so? (e.g. improving consumer confidence, providing a guarantee of quality, or others?)

No comment.

8. What outstanding pension-specific consumer protection issues could a self-regulatory approach help deal with?

No comment.

9. How and by whom should the effective application of the code be monitored?

No comment.

10. **Would an EU certification scheme be the best way of improving consumer protection for third-pillar retirement products?**

The NAPF operates its own certification regime, the Pension Quality Mark (PQM), for workplace schemes. The PQM is available to both contract-based and trust-based workplace pension schemes, provided they meet the PQM standards on contributions, governance and communications. Some of the PQM standards may be relevant to individual personal pensions and the NAPF would be happy to share its learning with the European Commission.

If an EU certification scheme is applied to third pillar retirement products using the current definition, there may be some overlap with PQM schemes. However, the NAPF would warn against applying a single certification scheme to both group personal pensions and individual personal pensions. The involvement of an employer radically changes the nature of these products and, therefore, consumers are exposed to very different risks in each.

The solution to this problem, as discussed above, is to ensure that group personal pensions are regulated as second pillar retirement products. An EU certification scheme could then be applied to individual personal pensions only.

11. **For which objectives would it be the best way of doing so? (e.g. improving consumer confidence, providing a guarantee of quality, or others?)**

Provided the EU certification regime applies only to individual personal pensions, and that employer sponsored personal pensions are regulated under the second pillar, the NAPF has no view on this issue.

12. **What outstanding pension-specific consumer protection issues could an EU certification scheme help deal with?**

No comment.

Contact

James Walsh
Policy Lead: Europe and International
020 7601 1720
james.walsh@napf.co.uk