Department for Work & Pensions

FINANCIAL CONDUCT AUTHORITY

Remedying Poor Value Legacy Workplace Pension Schemes: Findings from the Joint Review of Industry Progress against the Independent Project Board Recommendations

December 2016

Summary of Findings from the Review of Industry Progress against the Independent Project Board Recommendations

1. Summary

1.1 This report summarises the findings from the Department for Work and Pensions (DWP) and the Financial Conduct Authority's (FCA) joint review of industry progress in remedying poor value workplace pension schemes. It also outlines next steps and the key actions we are looking to pension providers, Independent Governance Committees and trustees to take.

1.2 Overall, the industry has made significant progress. For an estimated two thirds of the savings held within workplace pension schemes identified as being poor value for money, costs and charges have been, or will shortly be, reduced to a level of 1% or less. This means that over a million customers[1] within these schemes are subject to lower charges than before, potentially resulting in larger pension pots to fund their retirement.

1.3 However, there is still work to be done: in some cases there are schemes where providers[2] have written, or plan to write, to customers asking for their permission to move them to lower charging schemes – if customers respond and grant this permission this will improve the overall position across the industry even further. We will continue to engage with these providers as it is not yet clear how they will improve the value of these schemes in the event that customers do not respond.

1.4 In respect of a small number of schemes, we are concerned that providers have not yet taken sufficient action and customers are still exposed to higher costs and charges. We are looking to providers to address this as a priority. The DWP, The Pensions Regulator (TPR) and the FCA[3] will take further action to work directly with these providers to address these concerns.

2. Background

2.1 In 2013, the Office of Fair Trading (OFT) undertook a market study into both contract and trust-based[4] defined contribution (DC) workplace pensions[5]. As part of its findings, the OFT identified an estimated £30bn of customers' money in schemes with charges at risk of delivering poor value for money. Typically these schemes had charges or

1 For the purposes of this report, the term 'customers' refers to a member of a contract-based or trust-based scheme.
2 For the purposes of this report, the term 'provider' is used to refer to a provider of workplace pension schemes as defined in the Independent Project Board report.
3 DWP is responsible for welfare, pensions and child maintenance policy; TPR primarily regulates trust-based work-place pension schemes in the UK and are also responsible for helping ensure employers meet their Automatic Enrolment obligations; and the FCA is responsible for regulating the standards of conduct in retail (including contract-based schemes) and wholesale, financial markets and for supervising the infrastructure that supports those markets.
4 In a contract-based scheme an employer appoints a pension provider, often an insurance company, to run the scheme. In a trust-based scheme a board of trustees manage the scheme.
5 Defined contribution workplace pension market study, Office of Fair Trading, September 2013, http://webarchive.nationalarchives.gov.uk/20131101164215/http:/www.oft.gov.uk/shared_oft/market-studies/oft1505

multiple charge structures which equated to a reduction in yield (RIY) of more than 1%[6].

2.2 In response to these findings, the Association of British Insurers (ABI) established an Independent Project Board (IPB)[7] to oversee an audit of these schemes. The IPB undertook a comprehensive assessment of charges, using data provided by pension providers, and found that approximately £25.8bn of Assets Under Management (AuM) and approximately 1.5 million customers were potentially exposed to costs and charges of more than 1%, split as follows:

- Approximately £24bn in contract-based schemes
- Approximately £2bn in trust-based schemes

2.3 The IPB recommended that providers of such schemes review the output from this audit, identify (by June 2015) what actions could be taken to reduce costs and charges and provide better value for money[8] for customers and agree an implementation plan with relevant governance bodies, specifically Independent Governance Committees (IGCs)[9] and trustees, by 31 December 2015. The IPB did not set a deadline for providers to complete their agreed actions.

2.4 The IPB also recommended that the DWP and FCA undertake a joint review of progress in addressing and remedying these poor value schemes and publish a report by the end of 2016.[10] This report is our assessment of the progress providers have taken to address the IPB's concerns.

2.5 Using the original IPB audit scope, the DWP and FCA issued information requests to 23 pension providers and conducted a desk based analysis of the information to determine whether the actions taken or agreed would address the IPB's concerns and improve the outcomes for customers.

2.6 Given that our review is based on information received in June 2016, and the IPB did not stipulate a deadline for actions to be completed, some providers may have subsequently addressed or begun to address some of the remaining issues described in this report.

3. Overall Findings

3.1 A substantial majority of customers in both contract and trust-based workplace pension schemes are receiving, or will receive, an improved outcome with costs and charges being reduced to 1% or below. However, there are a small number of providers whose progress is unsatisfactory, details of which are given below.

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[6] The IPB used a percentage Reduction in Yield figure to illustrate the impact of different charging structures, personal circumstances and behaviours based on 37 hypothetical saver scenarios. This is broadly equivalent to an Annual Management Charge.

[7] The IPB constituted members from a broad group of interested parties including, the Department for Work and Pensions, the Financial Conduct Authority, the Pensions Regulator, the ABI, the Competition and Markets Authority, the Institute and Faculty of Actuaries, the National Association of Pension Funds, the Pensions Advisory Service and an independent consumer advocate.

[8] The Independent Project Board stated that there was no 'one size fits all' charge structure that would assure that all customers get 'value for money' all of the time. Value for money will depend on customers' decisions and behaviours and important qualitative factors including governance, investment performance, transaction costs and communication with customers.

[9] The role of IGCs is to represent the interests of scheme saver in assessing the value for money of pension schemes, challenging providers to make changes where necessary.

[10] See page 12 https://www.fca.org.uk/publication/research/defined-contribution-workplace-pensions-ipb.pdf

3.2 Of the £25.8bn AuM identified as being potentially exposed to costs and charges of more than 1%, our findings can be split into three tranches:

3.3 Providers have implemented actions, or have in place clearly planned and timely actions, to reduce the costs and charges to 1% or below on 68% of the AuM in contract-based schemes (approximately 918,000 customers benefitting from reduced costs and charges), and 64% of the AuM in trust-based schemes (approximately 139,000 customers).

3.4 This has been achieved primarily by reducing product charges to either 1% or 0.75%. In addition, the introduction of the charge cap on default funds[11] in schemes used for automatic enrolment has seen providers reduce AuM costs and charges to 0.75%. Providers have also capped or removed some policy fees, commission charges, paid-up charges and/or exit charges.

3.5 For a further 16% of the AuM for contract-based schemes (approximately 189,000 customers) and 21% of the AuM for trust-based schemes (approximately 42,000 customers), a small number of providers have implemented actions which rely on a response from another party such as the individual customers or the trustees. For example, where consent is legally required by the terms of a contract e.g. when moving large groups of customers from one investment platform to another. When fully implemented, these actions will reduce the costs and charges to 1% or below.

3.6 DWP and FCA will continue to engage with these providers to ensure that these customers are not being disadvantaged over the long term especially where there has been no or slow responses from individual customers or trustees. We would encourage providers to consider a reduction in costs and charges on customers' existing funds, rather than transferring customers to other funds, where flexibility in the scheme contract allows this.

3.7 For the remaining 16% of the AuM in contract-based schemes (approximately 243,000 customers), and 15% of the AuM in trust-based schemes (approximately 85,000 customers[12]), progress is unsatisfactory or unclear (see paragraphs 4.1 and 6.1 below). For both contract and trust-based schemes, the AuM identified as being still at risk of costs and charges above 1% is not evenly spread across the providers in our review sample but primarily relates to a small number of providers.

3.8 In general, providers have considered qualitative factors such as communications and investment options in their value for money assessments; however, a small number of providers have only given limited consideration to qualitative factors and in the final agreed actions with IGCs or trustees. Consequently, these assessments may be limited and may result in valuable customer benefits not being fully considered from a value for money perspective.

3.9 At the time of our review we found that most providers had not fully reviewed the impact of transaction costs in their value for money assessments and in most cases had no immediate plans for a fuller review of these. We had expected providers to have made more progress in this area particularly providers using in-house investment management services.

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[11] The DWP publication March 2014: Better Workplace Pensions: further measures for customers.

[12] This figure includes a provider which had a significant number of customers. If that provider is removed the figure would fall considerably to around 14,000 customers in this category.

3.10 Despite the significant progress made by the industry, the DWP and FCA are concerned by the lack of progress by a small number of providers and the impact it has on customers and their pensions. We will engage urgently with these providers (no later than January 2017) to agree robust actions to address the remaining 16% of the AuM in contract-based schemes and 15% of the AuM in trust-based schemes that remains subject to high costs and charges.

4. Specific findings related to contract-based schemes

4.1 In respect of the issues listed in para 3.7 relating to the 16% of AuM, providers have:

- implemented reductions to costs and charges on a *temporary* basis only until a permanent solution is found (3% of the AuM).
- taken the view that certain ancillary saver benefits (for example, guaranteed annuity rates or with-profit guarantees) justify higher costs and charges, but did not provide evidence of a detailed value for money assessment to explain why this justifies not reducing charges (7% of the AuM);
- not adopted the same methodology as the IPB in their assessment of which groups of customers are at risk and therefore cannot demonstrate that they have fully addressed those schemes at risk (3% of AuM); and
- agreed actions that do not fully address the IPB recommendations (3% of AuM).

5. High level findings in respect of the role of IGCs

5.1 Broadly, we found IGCs to be generally effective, and acting in accordance with their Terms of Reference, by influencing, supporting and advancing the reduction in costs and charges that has been achieved so far. The majority of IGCs have been promptly and effectively consulted, provided with sufficient information to evaluate provider actions, have requested further information where needed, and engaged with providers in a timely and appropriate manner.

5.2 However, in specific instances, and particularly where actions have not yet been taken by providers to reduce the costs and charges on schemes, we believe that IGCs could have played a more proactive and rigorous role in driving providers to agree robust actions more quickly. In addition, where IGCs have agreed temporary actions or actions which depend on customer responses, we would have expected IGCs to have challenged the provider and agreed an alternative solution for customers who do not engage and/or to have considered whether proactive action to reduce charges could have been taken notwithstanding any restrictions within the scheme contract.

5.3 In a small number of instances the independence of the IGC may be compromised due to its composition and/or a strong senior management presence at meetings which could impact the IGC’s ability to independently assess and challenge the provider’s actions to address the IPB recommendations. Providers and their IGCs should be mindful of their obligations to maintain independence.[13]

5.4 Providers with customers investing in traditional with-profits schemes have, in a small number of cases, determined that the presence of a With Profits Governance

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[13] Under COBS19.5.

Committee (WPGC)[14] lessens the need for the IGC to scrutinise value for money. The FCA does not expect an IGC to waive its oversight of value for money for customers and providers should be clear about the respective roles of the IGC and WPGC.

5.5 Based on the information provided, where providers have elected to use a Governance Advisory Arrangement (GAA)[15], there is insufficient evidence that engagement, interaction and challenge between the GAA and providers is present. We would like GAAs to clearly evidence their engagement and challenges provided to firms in their interactions in respect of value for money for customers.

6. Specific findings related to trust-based schemes

6.1 In respect of the issues listed in para 3.7 relating to the 15% of AuM, providers have:

- agreed actions that do not fully address the IPB recommendations (2% of AuM);
- only taken action in relation to member pots of a certain value leaving the other pots at risk of high charges (2% of the AuM); and
- taken the view that certain ancillary saver benefits (for example, guaranteed annuity rates or with-profit guarantees) justify higher costs and charges, but did not provide evidence of a detailed value for money assessment to explain why this justifies not reducing charges (11% of the AuM).

6.2 Those providers who wrote to trustees alerting them to the IPB findings generally faced low response rates, particularly in relation to trust-based schemes that were closed to new customers and whose customers were no longer making contributions. Some of these providers advised that the particular nature of their trust-based schemes meant that they were unable to take action without explicit instructions or agreement from the trustees, as the trustees were responsible for making decisions. However, another provider cited terms in their scheme contract which meant that they could reduce charge levels without seeking trustee consent.

6.3 TPR acknowledge the problem that providers can face with occupational schemes that may have become "orphaned" (i.e. where there seems to be no employer or trustee still in place). It is currently engaged with a number of providers testing options for winding up these schemes.

7. Next Steps

7.1 The DWP, TPR and the FCA, welcome the significant progress made by those providers who have put in place actions that have removed or are in the process of removing around two-thirds of the AuM at risk of costs and charges above 1%. We will seek confirmation that actions agreed but remain outstanding are fully implemented.

7.2 Our focus going forward will be on the 16% of AuM in contract-based schemes and 15% in trust-based schemes which we have identified as remaining at risk of costs and charges above 1%, and the steps we will take to ensure that this is addressed.

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14 Under Conduct of Business Sourcebook (COBS) 20.5.3R a with-profits committee is expected to represent the interests of with profit policyholders.

15 Providers with smaller and less complex workplace pension arrangements are allowed to appoint an independent third party (referred to as "a governance advisory arrangement" (GAA)) to take on their IGC responsibilities.

Actions for providers and IGCs/Trustees

7.3 The DWP and the FCA will engage with the small number of providers that have not reduced charges to encourage them to take action. We will seek to ensure that all customers in workplace pension schemes that remain subject to costs and charges greater than 1% are either in schemes that are fully assessed as being value for money or will benefit from charges of 1% or under within a reasonable timeframe.

7.4 We expect IGCs to challenge these providers and agree actions that fully address the IPB recommendations as a priority going forward. We expect IGCs to provide robust challenge on both the quality and timeliness of actions proposed by providers. This was a particular concern where providers are using a GAA.

7.5 Where providers have taken action to reduce charges, both providers and governance bodies (IGCs and trustee boards) will need to monitor the services provided to customers for any evidence of deterioration in quality, as a part of the overall value for money proposition[16].

7.6 Assessing and securing value for money remains a key responsibility for IGCs as required by the FCA rules and for trustees in the standards of conduct and practice[17] now in place to help trustees comply with their legal duties.

7.7 Providers and IGCs should engage with the recently published Consultation Paper (CP16/30) entitled 'Transaction cost Disclosure in workplace pensions' published in October 2016. The consultation closes on 4 January 2017.

Actions for the FCA and the DWP

7.8 We will issue detailed feedback letters to providers in the sample in the New Year for both contract-based and trust-based schemes.

7.9 Where further action is required to address costs and charges remaining above 1%, we will write to providers no later than January 2017 and set out the actions we expect them to take to ensure that no customers remain at risk over the longer term. We will specify deadlines by which these actions should be completed and will engage further with these providers by no later than the 30 June 2017.

7.10 We would expect those providers who might claim they are unable to take any further action to explain fully the reasons behind this. In addition, where providers have claimed the AuM at risk has valuable benefits linked to them, we would expect the provider to show clearly why the valuable benefit justifies charge levels above 1%.

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16 In line with FCA expectations for contract-based schemes as outlined in COBS19.5.

17 http://www.thepensionsregulator.gov.uk/codes/code-governance-administration-occupational-dc-trust-based-schemes.aspx#s22009