age UK
Love later life

Sinead Donnelly and David Farrar
Department for Work and Pensions
Policy Group
Private Pensions and Arm's Length Bodies Directorate
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Dear Sinead and David,

I am writing in response to your consultation 'Investment Innovation and Future Consolidation'. Firstly, Age UK welcomes many of the proposals contained in the document. We recognise the benefits that greater consolidation among pension schemes can bring, in particular the economies of scale and the potential to raise governance standards. These could improve retirement outcomes for many scheme members, in particular those in smaller schemes.

Preventing the charge cap becoming a 'target'

We have concerns about the possible impact of illiquid investments on the charges levied by pension schemes/trustees. Delivering good value, of which lowering charges for consumers is a significant part, should continue to be the policy aim. As illiquid assets are typically more expensive, there should be a continued emphasis on consumer outcomes and the overall level of charges passed on to scheme members. At present, many schemes maintain lower charges well below the cap, which as you are aware is currently set at the equivalent of an annual management charge of 0.75 per cent, but there are no guarantees this will continue in future, especially if schemes are placed under pressure to invest in more expensive assets. The default fund charge cap must be viewed as a maximum level and should not become a target or the objective of delivering good value will be compromised, in particular for smaller savers whose money can be quickly eroded by high charges.

Problems with illiquid investments

We are concerned there is a lack of evidence for an 'illiquidity premium' and even if this does exist – as claimed by the investment industry – it will not apply equally to all asset classes. In any case, increases in charges should not be passed on in full to consumers. For consumers to pay more there must be clear evidence that any excess charges/fees are real and derive a long-term benefit to savers.

Because illiquid investments are not subject to daily valuations, it is difficult to provide accurate information to trustees/schemes. The 'sticky' nature of valuations can make them appear less risky than they are in reality, potentially misinforming the pension schemes about the appropriate level of fees/charges and exposing consumers to undue risk. This issue needs to be resolved to enable trustees to invest in illiquid assets with confidence.

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Lowering the charge cap
Following the previous review of the charge cap in November 2017 the Pensions Minister said in a Written Ministerial Statement (WMS):

> *"[At the next review] in 2020 we intend to examine the level and scope of the charge cap, as well as permitted charging structures, to see whether a change is needed to protect members. This will also allow us to evaluate the effects of the next stage of AE and the new master trust and transaction costs regimes. Whilst we are not pre-judging the decision, we expect there to be a much clearer case for change in 2020."*[i]

This provides a clear indication that at this time there was an expectation that the charge cap would be lowered in future. While Age UK appreciates that lower charges may sometimes restrict investment choices and therefore not necessarily deliver the best outcomes for savers, we believe there should be a presumption that lower charges are preferable unless the industry can prove otherwise. Given the opaque nature of the investment industry and the lack of clarity over the benefits of illiquid assets, we are concerned that the current drive to promote illiquid assets could change the footing of the debate, in effect making it more focussed on the wider economy and less on consumer outcomes. We would welcome a Government statement to address these concerns.

Transparency
The WMS also emphasised transparency as being a major concern. The investment industry is still often shrouded in mystery to consumers, and while steps have been taken by the Government and the FCA to improve transparency, there is still a lot of scope for improvement. At a minimum, the reporting on illiquid assets should include charges and the net return after charges, although we would like to see a full evaluation of their wider costs and benefits. Best practice should be established and followed relating to reporting of all associated fees/charges.

We are pleased the Government believes that illiquid investments should be perfectly workable at 0.75 per cent, and urge the points raised above to be considered when developing policy in future.

Pensions 'freedom and choice'
Additionally, the introduction of the pension 'freedom and choice' reforms have raised new concerns over charges, especially for people using income drawdown who are exposed to high charges and/or inappropriate investments. We welcome the FCA's current consultation on 'investment pathways' which we consider to be a significant step in the right direction.

However, the FCA's current proposal to build a comparison tool for drawdown products is on its own likely to be insufficient to improve outcomes – forthcoming research commissioned by Age UK suggests a high degree of scepticism across the pensions industry about the wider benefits of this tool. We are happy to share this research with you once published.

Further measures will be necessary to deliver good outcomes to non-advised drawdown customers. We believe that a charge cap is necessary to protect consumers who have accessed their pension, which should initially be set at 0.75 per cent and kept under review. This should work in tandem with other measures to ensure that all consumers can fully benefit from their pension savings.

Yours sincerely,

Christopher Brooks
Acting Head of Policy, Age UK

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[i] Pensions: Written statement - HCWS249, 16 November 2017