B&CE response: Retirement Outcomes Review: Investment pathways and other proposed changes to our rules and guidance

About us

B&CE is the provider of the People's Pension, a not-for-profit master trust which delivers a workplace pension to more than 4 million mostly low and medium income savers. B&CE is a not-for-profit provider of straightforward financial products, founded by construction industry employers and trade unions in 1942. We have recently completed the transfer of nearly half a million customers from our legacy contract based DC arrangement to The People's Pension master trust because of the higher governance standards and lower charges of the latter.

Introduction

We are grateful for the opportunity to respond to this consultation. The investment pathways proposal in our view represents a step forward insofar as they represent a departure from unsuccessful information remedies. But the step forward is small and we believe further reform is needed.

Soon, a generation will arrive at retirement that has exclusively saved in DC pensions and will, increasingly, have only experienced automatic enrolment. The standout feature of AE is its reliance on inertia and the legal prohibition of any requirement to force savers to make a choice in order to save in a pension.

Unlike with DB pensions, where people reach retirement and receive an income, these DC dependent retirees will be expected to make a series of complex choices that many are not equipped to make. The extent of the difficulty people have in making "at retirement" choices can clearly be seen in the research commissioned to support the development of the investment pathways. The central finding of the research is that less than half of the research sample were able to choose the "correct" option[1].

It is not just the reliance on informed choice that is likely to be problematic. Providers can charge what they like in the absence of a charge cap. Governance is weaker in the contract based sector than at the top end of the trust based sector. While the proposed extension of the role of IGCs to decumulation is welcome, IGCs are not a substitute for a trustee. Trustees in a modern master trust occupy a role similar to company directors in a limited company. The same is not true of IGCs whose role is advisory and much weaker as a result.

Moreover, there has been little discussion of Australian style streamlined retirement products, notwithstanding their inclusion in the original ROR report. There has also been no discussion of other aspects of international best practice e.g. national brokerages solution pushing to customers to best buy.

As a master trust with scale we have a strong interest in the future regulation of DC decumulation, which is crucial to our more than four million members. Most of these people will want and expect an income from their pension in retirement, as a top up to the state pension. Our trustees have mandated The People's Pension to develop a retirement solution that will allow scheme members to decumulate from the scheme, which is

[1] https://www.fca.org.uk/publication/research/increasing-comprehension-of-investment-pathways-for-retirement.pdf

currently in development. Our research with members suggests that a hybrid solution combining both drawdown and longevity protection best meets member needs.

The pathways address specific flaws in FAD

The direct application of the pathways remedy is narrow and focused on particular harms tied to non-advised drawdown in the contract retail pensions market. The pathways themselves do not serve as a wider model for dealing with other potential harms arising from the pension freedoms.

In part, this is because flexible drawdown has serious drawbacks. The most serious is that it does not always address the main issue in DC retirement planning: how to make a fund last an uncertain length of time, especially when sold without advice. Used by itself without advice and where a saver is reliant on DC for a lifetime income it is not likely to be a suitable replacement for a combination of products that includes an annuity. We think this is true whether or not FAD is sold in its current form or, potentially, as an investment pathway.

For this reason, we see the pathways as an important step forward in the regulation of non-advised drawdown but they are an incremental improvement on a product that we see as fundamentally flawed for the mass market. In our view, this is not a model that can be adapted and applied directly elsewhere in the "at retirement" market.

The thinking behind the pathways has wider application

We feel that the, thinking behind the pathways, though, does have wider application. There are two things about the pathways that are noteworthy. They make use of choice architecture in order to try and protect the customer. We think that this approach could be used more generally to present at retirement choices in a more structured manner or, potentially, to allow a default income to be paid – much as DB pensions allow a default income to be paid. If someone does not wish to take an income from their DB pension, they are at liberty to convert it to DC and act as they wish.

At the moment, the ROR shows that people are often taking small pots as cash. It is probable that many of them have other, larger, DC pots and many of them will also have DB entitlement. In the future, we expect people to retire with larger DC pots, perhaps consolidated through the dashboard and only those who have worked in parts of the public sector will have DB. But research we undertook in concert with State Street showed that people relying on large DC pots now were making bad choices now.

Second, they involve specification of a product within certain parameters. We think this approach will likely prove useful as the market evolves. We think that regulating specific products will become increasingly common as the "at retirement" market evolves. This is because, while the freedom element of the pensions freedoms is welcome, the choices now required are hard and the risks substantially greater than those involved in an annuity purchase. Common sense, as well as the initial behaviours evidenced in the post pensions freedoms market, indicate specifying some elements of a product may be the best or only way to mitigate particular risks.

Proposal to extend the remit of IGCs

In the absence of any more significant proposals to strengthen contract based pensions governance so that providers are obliged to put members interests first, extending the coverage of IGCs to investment pathways becomes the least worst option. We note that the FCA undertook to engage in a full review of IGC's effectiveness but has not yet done so. This should be a priority.

As we laid out in our response to the FCA's consultation on a duty of care, we do not believe that IGCs offer an equivalent standard of governance to that offered by a trustee. In a master trust or single employer trust, the trustees run the scheme. They are responsible in law for the running of the scheme and the trustees have to apply for authorisation by The Pensions Regulator as a master trust pension scheme. Trustees of larger schemes are treated in a manner similar to board members in a publicly listed company (PLC). Those familiar with PLC

board members will know that shareholder value is a constant concern. Replacing the term “shareholder” with “member” provides a feel for how trustees operate. The trustees can sack the underlying provider if they deem it to be no longer meeting the members’ best interest. The requirements on trustees to avoid conflicts of interest are strict.

IGCs do not have the same legal powers as trustees. They have an advisory rather than an executive role. While in theory they could complain to the FCA if their views are ignored, this power is far weaker than that of trustees. The contract provider is also permitted to appoint a minority of members of the IGC, who are not independent. The latter are thereby able to monitor the behaviour of the independent members on behalf of the firm as well as vote on decisions. In addition, those appointees meeting the definition of independence include employees of other companies providing services to the contract-based provider, as long as Chinese walls are appropriately managed.

We do not feel that the imposition of a duty of care on IGCs or on providers would bring contract based provision up to the same standard of governance as the best of the trust based world. This is because a duty to exercise reasonable care or skill speaks to competence, which is not at issue, while fiduciary duty speaks to motive and culture, which is a bigger problem in financial services. Fiduciary duty is the better choice if the need is to safeguard savers’ best interests.

Reponses to consultation questions

Q1: Do you agree with our proposed rules on when a consumer must be offered investment pathways, including how consumers who enter drawdown in stages should be treated, and that those who take an UFPLS are not included?
Yes.

Q2: Do you agree with our proposal that all providers of drawdown to non-advised consumers should be covered by our requirements on investment pathways, including SIPP operators?
Yes.

Q3: Do you agree with our proposed 4 objectives, and mandating all providers to use our prescribed wording when presenting these objectives?
Yes.

Q4: Do you agree that providers should only be able to offer 1 pathways solution for each investment pathway objective?
Yes. The purpose of the pathways is to streamline choice. Offering more than one pathway solution per pathway objective would undermine this.

Q5: Do you agree with our proposed rule requirements for the choice architecture, and do you agree that providers can offer investment pathways without giving the consumer a personal recommendation?

No response.

Q6: Do you agree with our proposed rule to prevent providers from offering the same pathways solution for all the objectives?

We agree with the proposed rule. The objectives are sufficiently different to require a different asset allocation for each objective.

Q7: Do you agree with our proposed rules on labelling of pathways solutions?

Yes.

Q8: Do you agree with our proposed rules requiring larger providers to provide pathways solutions for at least 2 of the 4 objectives and to refer consumers to another provider's pathways solutions for any objectives where they don't provide a pathways solution?

Yes.

Q9: Do you agree with our proposed easement for smaller providers, including our proposals for the operation and level of the threshold for qualifying for this easement?

Yes. We recently closed our stakeholder scheme and transferred the overwhelming majority of customers to our master trust pension scheme because of the lower charges and higher quality governance of the master trust.

We do, though, have a small number of customers remaining in the stakeholder that we have yet to transfer out. While we have no plans to offer FAD from the stakeholder, we think it makes sense for product ranges or providers with only a small number of customers or remaining customers to be exempt from the requirement. The cost of providing the pathways relative to the benefit derived from a product with few remaining customers would be disproportionate.

Q10: Do you agree with our proposed approach to product governance for firms manufacturing pathways solutions used to provide investment pathways? Do you agree with our proposed approach for distributors?

The proposed approach deals with a clearly identified disparity between provision of drawdown through the means of an insurance contract and drawdown provided by other means. It makes sense on its own terms.

Q11: Do you agree with our proposed approach for ongoing information to consumers using investment pathways? Do we go far enough, or is there anything further that providers could do to ensure that consumers carefully consider their investment choice on a periodic basis?

We see the information prompts as a necessary but not a sufficient condition to encourage consumers to review their investment choices. The FCA should keep this aspect of the pathways under review in order to see how effective it is at achieving the desired result.

Q12: Do you agree with our proposed approach for the records providers should keep?

No response.

Q13: Do you agree with our implementation timeline?
No response.

Q14: Do you agree with our proposals to ensure cash investment is an active choice?

Yes.

Q15: Do you agree with our proposals on the warning about investment in cash that the non-advised consumer will get when they enter drawdown or transfer-in funds in drawdown to a new provider?

Yes, although we are sceptical about the effectiveness of information remedies. As with other information remedies, we feel that the FCA should keep the effectiveness of this approach under review.

Q16: Do you agree with our proposals on the ongoing warning around investment in cash?

Yes. We do, though, see risk warnings as a necessary but not a sufficient policy instrument to prompt people to change their asset allocation from cash. We feel that the efficacy of the risk warnings should be kept under review.

Q17: Do you agree with our proposed approach for the records providers should keep?

No response.

Q18: Do you agree with our implementation timeline? In particular, do you agree with our view that these remedies should be implemented at the same time as investment pathways?

Yes.

Q19: Do you agree that, in relation to their decumulation pensions, unless charges are built into the disclosed price of the product, consumers should receive information at least annually on all the actual charges they have paid, aggregated and expressed as a cash amount?

Yes. Consumer should be able to see the cost of the products they have purchased both in the accumulation and decumulation phases.

Q20: Do you agree that our rules should require disclosure of transaction costs, but not specify how transaction costs should be calculated?
Over time we believe that the method for calculating transaction costs should be harmonised between accumulation and decumulation such that consumers have a clear and comparable idea of costs and charges.

Q21: Do you agree that firms should disclose the adviser charges paid out of the product, or clarify that adviser charges are not included in the annual pension charges figure they disclose?
Yes.

Q22: Do you agree with our implementation timeline?
No response.

Q23: Do you have any comments on our cost benefit analysis?
No.