Work and Pensions Committee
Pension costs and transparency inquiry
Low Incomes Tax Reform Group (LITRG) response

1 Executive Summary

1.1 We welcome the opportunity to provide input into this inquiry. We do so as tax specialists, rather than overall pensions or regulatory experts, with a particular focus on the low-paid and unrepresented – who often have weak literacy and numeracy skills and may not be financially savvy.

1.2 We feel able to comment on the broad issues raised in the inquiry, given the importance of tax across the whole realm of pensions and the way it is inextricably linked with the wider issues of information, risk and return.

1.3 Higher-cost providers may well deliver higher performance but many in our constituency will have little appreciation of what the costs are in the first place, let alone why they may be paying them. It is also important to recognise that there is a deep mistrust of the pensions industry. Some people will always be suspicious of higher-cost providers, assuming that higher costs are down to dishonesty or sharp practice rather than quality of service.

1.4 Whether workplace pensions offer value for money (as far as workers are concerned anyway), comes down to three things – the amount going in, the amount going out and the underlying growth. We think there are probably issues with all three elements – but in particular, the low-paid earning below their personal allowances in net pay arrangements are not receiving the Government top-up to their contribution. Therefore, workplace pensions certainly offer less value for money for them.

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1.5 Regulating providers is probably more effective currently than empowering consumers. If the 'switching' system were lubricated, however, and consumers were able to vote with their feet, then this could have a positive impact on poor practice, as the market would start to self-regulate.

1.6 At the moment, there are real barriers to transferring providers – not only are there the ominous threats of exit charges and loss of perks at every turn (which may not actually be that significant), but the ubiquitous instruction 'to speak with your pension provider' is enough for those who may lack confidence, to put transferring elsewhere into the "too hard" basket.

1.7 Automatic enrolment has revolutionised pension saving for many. However, once 'in', little further thought will be given to pension pots. A multi-pronged attack is required here, but if we were to have to pick a single thing that could improve engagement with pensions then it would be education – to demystify pensions, to highlight the power of compound interest, to develop financial capability, etc.

1.8 In terms of investment transparency – few probably consider what might be going on under the bonnet. However, we think this would change if the reality that their money might be invested in companies that that may operate in areas that conflict with the individuals' values, tobacco products or weapons for example, was fully explained to them.

1.9 More also needs to be done to bring the costs and charges out of the shadows. This is no better illustrated by the fact that even the charging structures for workplace pensions – where there is a charge cap – are confusing, opaque, and hard to compare.

1.10 Independent Governance Committees (IGC) have an important role in secure value for money from those new to the market, however there are many different way of measuring value for money and it is, as yet, hard to draw any conclusions as to their success or otherwise.

1.11 We think Independent Financial Advisers generally do offer value for money. That is why there is a very real need for free or affordable sources of advice, not just guidance, for the large proportion of the population to whom pensions are a remote concept conducted in a foreign language. The need for this free or affordable advice extends across the whole life cycle of pensions, from starting to save into a pension through continuing adequate contributions up to the point of starting to draw on those savings.

2 About Us

2.1 The LITRG is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

2.4 We are happy to discuss any of the points raised in this paper in more detail.

3 Questions

3.1 ***Do higher-cost providers deliver higher performance, or simply eat into clients' savings?***

3.1.1 One would like to think that higher cost providers deliver higher performance, but we do not really know. The bigger issue perhaps, is that some consumers may not recognise what costs they are paying in the first place. Further, while we recognise that costs have to be placed in to some context, we wonder how many of our constituency would understand that performance is key and cheapest is not always best. Basically, there needs to be a clearer understanding of what the costs are and why they are incurred.

3.1.2 We also think it is vital to understand that there is a huge mistrust of financial service providers – including the pension industry and their fees and charges. People may see high costs and wonder if the costs are excessive.

3.1.3 There are various underlying strands that feed into this, including complexity, negative news stories and rules that are constantly in flux but ultimately it is understandable if consumers believe that a pension provider is 'pre-disposed to misbehave if it's given the chance'.[1]

3.1.4 We know a lot of work is going into bringing about the wholesale changes required to tackle this perception, but the problem is that people's opinions are hard to reverse in the short term.

3.2 ***Is the Government doing enough to ensure that workplace pension savers get value for money?***

3.2.1 Most employee pension savers are auto enrolled into a 'one size fits all' default fund and may be on low incomes. It is therefore vital that they get value for money.

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[1] To quote industry insider turned campaigner is Andy Agathangelou, who in 2015 launched the Transparency Task Force https://www.bbc.co.uk/news/business-42790904

3.2.2 While we appreciate that a lot of work goes into trying to ensure this – e.g. the cap on charges, introduction of IGCs, etc. – it is highly likely that those who seek funds outside of the default, e.g. more actively managed, niche or ethical funds, will see better outcomes.[1] Therefore, we think more should be done to encourage savers to take individual responsibility and to select their own bespoke pathway, albeit with almost certainly higher charges.

3.2.3 In the long term, education about investing and reassurance about investing in equities, etc. is what is needed to facilitate this, especially amongst those on low incomes who have a more tenuous grasp of financial affairs. In the shorter term, workplace pension providers should do things like provide annual statements, showing not only what the savers pot looks like now (including investment growth and after scheme charges), but also a forecast predicting the likely outcome at retirement if present levels of savings are maintained. This could encourage greater personal control over levels of savings if individuals can see clearly where they stand and how that compares to where they wish to be.

3.2.4 Incidentally, recognising that value for money is not just about charges and investment returns but also about tax relieved/employer-funded contributions, we take the opportunity to highlight the fact that some workers are certainly receiving less value for money than others – i.e. those on low incomes who are in net pay arrangements and who are not receiving tax relief because they earn less than their personal allowances.

3.2.5 This issue affects those who earn over the £10,000 needed to trigger auto-enrolment, but below (or not very much above) the £11,850 income tax threshold, who are enrolled in a net-pay pension scheme rather than a relief at source scheme.

3.2.6 Under relief at source arrangements, members of pension schemes who do not pay income tax are nonetheless permitted the basic rate tax relief (20%) on pension contributions up to £2,880 a year. In practice this means that HMRC will top up a net contribution of £2,880 to a gross £3,600. The government-backed pension provider, NEST, uses a relief at source scheme, as do various other auto-enrolment scheme providers.

3.2.7 However, this tax relief is not available to non-taxpayers for schemes that operate net pay arrangements, like NOW: Pensions, and the vast majority of occupational and trust based schemes. It is such an important issue that some pension providers are topping up non-taxpayers' pension pots out of their own pockets to offset the shortfall.[2]

[1] http://www.thisismoney.co.uk/money/pensions/article-5946619/Whats-secret-early-retirement-Ditch-default-work-pension.html

[2] https://www.nowpensions.com/press-release/now-pensions-top-non-taxpayers-pension-pots-offset-net-pay-income-tax-relief-shortfall-second-year/

3.2.8 In the recent DWP review of auto-enrolment[1] it was stated: 'The government recognises the different impacts on pension contributions for workers earning below the personal allowance. To date, it has not been possible to identify any straightforward or proportionate means to align the effects of the net pay and relief at source mechanisms more closely for this population.' We do not think this is acceptable and that it should be possible to find a solution that addresses the issue.

3.3 ***What is the relative importance of empowering consumers or regulating providers?***

3.3.1 Empowering consumers means not only arming people with an understanding of their choices but also giving them the capability to act on that knowledge. If customers are unhappy with their providers' costs or investment performance/strategy, then they should be able to transfer elsewhere. But there seem to be inordinate difficulties in switching providers (see our comments in section 3.6 for more information).

3.3.2 In terms of consumer protection then, regulating providers is currently probably ten times as effective as empowering consumers. But if the practical barriers to switching could be overcome and the pension industry made it easier for a customer to up sticks and away swiftly and smoothly to a better value or more accommodating pensions provider as they wished, this would have huge impact in terms of driving up standards, as the market would self-regulate and good practice would drive out bad.

3.4 ***How can savers be encouraged to engage with their savings?***

3.4.1 Although auto-enrolment has widened the number of people who are saving into a pension, once 'in' we suspect many just hope for the best and do not give their pension pots much more thought.

3.4.2 Essentially, this can be put down to the fact that there is a lack of a sense of ownership over pension pots. This is largely because people do not understand how pensions work. There is also a widespread perception that pensions are complex and shadowy. More work is needed to demystify them and develop people's financial capability and pension confidence.

3.4.3 In terms of practical measures to help engage people with their savings, as stated in para 3.2.3, workplace pension providers should do things like provide annual statements, showing not only what the savers pot looks like now (including investment growth and after scheme charges), but also a forecast predicting the likely outcome at retirement if present levels of savings are maintained. Such a statement should also demonstrate the effect of compound interest. Simple charts showing the long-term benefits in cash terms of, say, an extra £5 or £10 a month saved, would help pique interest.

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1 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/668971/automatic-enrolment-review-2017-maintaining-the-momentum.PDF

3.4.4 In the longer term, we urge the FCA to continue working with Government to develop a Pensions Dashboard as this will surely motivate people to take an interest in their pensions saving.[1]

3.4.5 More broadly, in order to increase trust and confidence in pensions there must be clarity and reassurance that contributions and investments are in good hands and well-protected against incompetence and criminal acts. In order to reduce perceived complexity, it would be useful if the Government could stop tinkering with the rules – rules and systems should only be changed in the future if necessary to ensure improvement – not on an adhoc basis in order to be able to 'spring surprises' on Budget day.[2]

3.5 *How important is investment transparency to savers?*

3.5.1 In terms of understanding what the underlying holdings are in their portfolio – this will probably not be all that important to the vast majority of savers. If anything, savers will be interested in the overall performance of investments – rather than what is actually going on under the bonnet.

3.5.2 Saying that, this is probably because they do not realise that their funds may be invested in companies that are involved in areas that conflict with the person's own values and ethics – for example are involved in tobacco or weapons, say, or that damage the environment or co-operate with countries with 'a bad human rights record'. Investment transparency therefore needs to be improved so that people fully understand where their funds are being invested and can make an informed decision as to whether they are content with that or wish to change for ethical reasons.

3.5.3 Costs are another area where transparency could be improved. The fact there are issues in the workplace pension market – where there is a relatively firm grip on charges – demonstrates this.

3.5.4 For example, it is not always made clear to employees that the cap does not currently include transaction costs incurred by managing the underlying investment fund,[3] yet these can seriously erode the value of their savings. Moreover, some people would find it very confusing and counter intuitive that despite there being a charge cap, there are three different charging structures in the workplace pension market.

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[1] The Committee may also find our submission to the consultation on strengthening incentives to save for pensions interesting: https://www.litrg.org.uk/latest-news/submissions/150929-strengthening-incentives-save-pensions

[2] A recommendation made in the Better Budgets report: https://www.instituteforgovernment.org.uk/sites/default/files/publications/Better_Budgets_report_WEB.pdf

[3] https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Lords/2017-11-16/HLWS248/

3.5.5 Most providers have a simple annual management charge (AMC). However, NEST charges,[1] for example, are made up of two parts – a contribution charge of 1.8 per cent on each new contribution into a member's retirement pot and an AMC of 0.3 per cent on the total value of a member's fund each year. Whereas NOW pensions[2] charges, which are also made up of two parts, have a monthly administration charge of £1.50 and an AMC of 0.3%.

3.5.6 Peoples' ability to draw comparisons on charges is hampered by the fact providers are allowed to express their charges differently. This seems very unsatisfactory when thinking about those in workplace pensions who are new entrants to the market and who need the most support and protection.

3.5.7 When thinking about transparency, clearer communication and explanation is vital, but when it comes to costs, so too is having a standardised, single charge figure – expressed in pounds and pence ideally, that encompasses all charges.

3.6 ***If customers are unhappy with their providers' costs and investment performance/strategy, are there barriers to them going elsewhere?***

3.6.1 Yes – one only needs to read the GOV.UK guidance[3] on the matter to understand what the barriers are:

Before you make a transfer

Contact your current pension provider and the provider you want to transfer to. You'll need to check if:

- *your existing pension scheme allows you to transfer some or all of your pension pot*
- *the scheme that you wish to transfer into will accept the transfer*

If you transfer your pension, you may:

- *have to make payments to the new scheme*
- *have to pay a fee to make the transfer*
- *lose any right you had to take your pension at a certain age*
- *lose any fixed or enhanced protection you have when you transfer*

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[1] https://www.nestpensions.org.uk/schemeweb/nest/aboutnest/nest-charges.html

[2] https://www.nowpensions.com/wp-content/uploads/2016/02/Auto-enrolment-costs-and-charges.pdf

[3] https://www.gov.uk/transferring-your-pension/transferring-to-a-uk-pension-scheme

- *lose any right you had to take a tax free lump sum of more than 25% of your pension pot*

Your pension providers can tell you whether any of these will apply.

3.6.2 For our constituency, these vague risks will probably be enough for them to decide that the whole thing is a minefield and that it is therefore easier to stay with their current provider.

3.6.3 Even if they are not put off by the thought of exit fees and loss of perks, the simple instruction to contact their current pension provider and the provider they want to transfer to, will just seem an overwhelming or even impossible task. Many will not have the wherewithal, confidence or ability to articulate their wants and needs sufficiently, to be able to do this.

3.7 ***Are Independent Governance Committees effective in driving value for money?***

3.7.1 We do not know – IGCs are in relatively early days and there are lots of elements involved when determining value for money – charge structures, administration, communications, investment strategy, etc.

3.7.2 It is probably quite difficult to draw an overall conclusion – indeed we note the recent findings from ShareAction[1] 'that there isn't enough transparency to be clear whether IGCs are fulfilling their role'.

3.8 ***Do pension customers get value for money from financial advisers?***

3.8.1 In the vast majority of cases, we would very much hope so. However, going to an IFA for a full fact find, analysis of needs and expectations, etc. and search for an optimum solution(s) is likely to cost at least four figures. We have indeed heard reports of IFAs refusing to take on clients with less than £50,000 in their pension pots and some require even more.

3.8.2 There is therefore a real need for free or affordable sources of advice, for the large proportion of the population to whom pensions are a difficult and confusing subject and who may not be able to afford to pay an IFA or who have smaller pension pots that make finding an IFA difficult. We have previously put forward[2] the recommendation that the financial services industry should support their own charity to provide free professional advice to people on low incomes along the lines of the frontline tax charities, Tax Help for Older People[3] and TaxAid.[4] This would plug the gap in both the existing and proposed future models of financial guidance which only offer guidance, robo-advice, websites and

[1] https://shareaction.org/wp-content/uploads/2018/02/PolicyReport-IGCRanking.pdf

[2] https://www.litrg.org.uk/latest-news/submissions/151222-public-financial-guidance para 4.4 et seq.

[3] www.taxvol.org.uk Tax Help for Older people provides pro bono help and advice on tax to people of retirement age on modest incomes.

[4] www.taxaid.org.uk TaxAid provides a parallel service to people of working age

telephone helplines, none of which is a substitute for detailed face-to-face advice from a qualified and regulated source.

3.8.3 This is an area where the FCA and TPR should be concentrating their efforts – to persuade those in the financial services industry to engage and share a few hours of their time with the low-paid and vulnerable. The tax models have been working well for over 25 years; they would willingly share their experience to avoid re-inventing wheels. In particular, we are aware that some IFAs feel very strongly about the fact that younger people often go without advice due to price alone when it would likely be to their advantage to have ongoing advice well before retirement. So signing up volunteers may not be such a huge undertaking but there is potential for it to make a real difference.

LITRG
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