Pensions people can trust
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Introduction

It’s not just today’s working families who are taking a hammering from the Tory-led Government. It’s tomorrow’s pensioners too. Hard-pressed families have so little to make ends meet these days that convincing them to save for pensions is hard.

That’s why Britain’s new private pension system which starts in October is so important. Developed by Labour with cross-party support, 10 million workers will be ‘automatically-enrolled’ into private pensions. Together with state pensions, this could help workers replace up to half of their salary in retirement.

However, the problem of hidden costs and charges could end up costing savers up to half of their pension pot if they end up in the wrong scheme. The National Association of Pension Funds is drawing up an industry code on costs and charges, which is welcome, but David Cameron’s Government has failed to get to grips with the problem.

Right now, too many people don’t save for a pension because they don’t trust the system. Pollsters, ICM Research say 56 per cent of savers lack confidence in those who manage their investments. And Which? Say that just 6 per cent of the public believe our financial services industry is the most trustworthy custodian of a pension savers’ money. Bad schemes are undermining the many good ones, like our traditional defined benefit schemes and the high quality new schemes, which have trustees that manage the fund.

If the Government does not act quickly to restore public trust in the pensions industry then savers could vote with their feet and opt out of the new system of private pensions for all. That would be a disaster.

Labour is and will always be the party of hard working people who do the right thing. It is clear that millions are doing the right thing and saving for their retirement, but instead of rewarding them, the system is doing the opposite and giving them a raw deal on their pensions.

At a time when many hard-working people feel they pay a lot in but get very little out we need to restore the ‘something for something’ bargain.

Right now 60 per cent of private sector workers aren’t saving for a pension. The old defined benefit schemes are available to fewer and fewer private sector workers - this is why we need people to engage with the new workplace pensions system and why it must be high quality.

We are proud of our record on private pensions.

1 The comments provided by stakeholders in this document illustrate their view on a particular policy issue. Their comments do not necessarily imply that they support all the views expressed in this document and they do not imply that they support the Labour Party.
Labour introduced NEST, a low cost, public alternative. Furthermore, the 2008 Pensions Act which legislated for auto-enrolment and NEST. It included a power to cap charges.

Since then, Ed Miliband has been clear about the need to introduce greater transparency in the industry, with a simple charging structure. If this does not bring down the charges, they should be capped. We also believe that consumer watchdogs should have more teeth. There should be a duty on financial services to take the financial well-being of their customers into account which would be monitored by the Financial Conduct Authority.

In October, the new foundations for a private pensions system for all will fall into place. The Government must now act to ensure that on those foundations we build a world-class pensions system for 21st century Britain.

**Costs and charges**

People's pensions can be significantly reduced if the costs and charges are high. There are annual charges, but there are also hidden and obscure costs which can damage someone’s retirement, as well as poor value annuities, penalty charges on pensions when people move jobs and barriers to switching provider. The problems are:

- Firstly, there is a lack of transparency in the system. Some pension providers do not provide savers with full and clear information in a simple way. They only disclose the annual management charge which may comprise less than a third of the total costs and charges which are deducted from an individual's pension pot. The consumer organisation Which? has found cases where up to 50 per cent of someone’s savings would be absorbed by total costs and charges.

- Secondly, there are major rip-offs in the annuities market. When a saver retires they have to turn their savings into a retirement income, called an annuity. However, many savers end up buying annuities from the same company who provided their pensions. However, often this annuity is inferior to what could be obtained if they shopped around on an open market. This failure to shop around for a better deal can wipe 30 per cent off their annual pension income, and in some cases up to 50 per cent. Alternatively, a new central clearing house could offer the best annuity available.

- Thirdly, there are additional penalty charges which can be imposed when someone changes their job and leaves behind a pension pot which they had built up in their old job. The consumer organisation Which? say the higher forms of these charges can have the cumulative effect of shrinking someone’s pension savings by 25 per cent.

- Finally, there are also “exit” charges in some schemes if someone changes their provider. While many schemes do not apply them, an average employee changes jobs 11 times, so where it is applied the effect could be very damaging to someone pension fund.
**Aussie Rules - How the Australian’s are taking on hidden costs and charges**

The Australian government will require default products for automatic enrolment to be “simple and cost effective” from 2013. This is intended to make it simpler for members to understand what they pay and to compare fees between products. The fees a member can be charged for these products will be limited to:

- Administration fee
- Investment fee
- Buy and sell spreads (limited to cost recovery)
- Exit fee (limited to cost recovery); and
- Switching fee (limited to cost recovery)

**Comment:**

“If the pension is to re-engage the trust of consumers then transparency of costs, charges and restrictions is an absolute requirement. This transparency must cover all costs and charges, not only those directly paid by each individual member but any charges which will reduce the return on their investments. As an industry these charges are known as they contribute greatly to the profitability of pension providers and fund managers and their shareholders. This information should be freely available as it clearly is in the public interest. A pension plan is a long term commitment for both parties and long term relationships must be based on trust and honesty.”

*Douglas R.G. Baillie, Senior Partner of The Pension Specialist*

“There is no legal or technical bar to providing full disclosure of costs and charges; as well as holdings. Costs and charges are currently obscure and hidden in numerous different documents and reports, layered in convoluted language and this stops consumers from making fully informed and competitive investment decisions. There are no regulatory or business incentives for some parts of the industry to behave honestly and ethically, and this has to be addressed as a matter of urgency.”

*Gina Miller, Partner SCM, initiators of the True and Fair Campaign*

“It is vital that customer interest is looked after better by the annuity market. Currently, most people are at risk of buying the wrong kind of annuity and obtaining a poor rate, with nobody obliged to advise them of what they need to consider before buying this irreversible, once-in-a-lifetime product. Anyone in poor health, or who has a partner, or who wants inflation protection may not realise that they need a special type of annuity until it is too late. Commission is dedicated from the pension fund to cover advice, even if no advice is given. This is not in the customer’s interest.”

*Dr Ros Altman, Director-General of the Saga Group.*
The root cause of the problem

Firstly, there are problems with the market not working effectively and competitively. Pensions are complicated and most people do not understand how they work. Also people generally do not consume a sufficient number of pension products to learn over time which product works best. By the time we have used a pension, it is of course too late to switch.

Secondly, another reason the market does not always work effectively, is that employers, as opposed to employees, generally choose the pension. The choice the employer might not always be in the saver’s interests. A consumer might end up having to choose between saving into a poor pension or not saving at all.

Thirdly, there is also a lack of accountability. In the old defined benefits pension schemes, the trustees would manage the costs and companies would meet any shortfalls. But these are now largely closed to new members. In the new system, a saver’s pension depends only on the returns made by the investment. Only a minority of schemes in the new system, such as NEST, have independent trustees.

Fourthly, there is also an issue with scale. The larger the scheme, the more effective the governance. The Cooper review in Australia into occupational schemes recommended that trustees assess whether the size of the scheme was large enough to maximise savers’ interests.

Fifthly, an alternative could be made more effective. Labour set up NEST, which was a low cost, public alternative. But there are restrictions on NEST, which stop it from accepting transfers of pension savings which employees have built up in their past jobs with different pension providers. The other restriction prevents it from offering pensions to employees who wish to contribute more than £4,400 per year to their pension. These restrictions make NEST less effective. NEST is already widely recognised as driving standards higher throughout the industry. Since NEST is the low charge option for saver’s, making it more available will help to drive down charges further.

Finally, we want a private pensions system for all – including the low paid who want to do the right thing and save. At the moment the government has barred 690,000 of the lowest paid, often women in part-time work with caring responsibilities, from the new automatic workplace pensions. We say this is wrong.

Comment:

“My experience is that most workers find DC pensions an alien, and generally bewildering, concept. If the auto enrolment spur to savings is to have maximum beneficial impact then workers need to know there is someone who is unequivocally on their side. I strongly support improving the governance of DC schemes both by requiring “trustees” overseen by the Pensions Regulator and through facilitating the combining of small schemes into economically viable units.”

Ronnie Bowie, Senior Partner at Hymans Roberston and Past President of the Institute and Faculty of Actuaries
“Trust-based schemes operating at scale should be the goal of a pensions system operating in the savers’ interest”.

Lord McFall, former Chair of the Workplace Retirement Income Commission

“Hargreaves Lansdown believes that the pensions industry should always look to the best interests of investors. The special restrictions imposed on NEST simply make pensions more complicated and for this reason we support the proposal that the restrictions should be lifted. NEST will serve a useful purpose as an underpin for auto-enrolment, and any commercial company that fears its own offering is not competitive should look to the quality of their own product or service, not seek to restrict NEST”.

Ian Gorham, Chief Executive of Hargreaves Lansdown PLC.

“One of our clients participates in an insurance company’s mastertrust where the charge the member pays on the default fund is 1% pa. The insurance company has offered to reduce the charges on units purchased from future contributions but not on the funds already accumulated. As it is the impact of the 1% charge on existing funds that concerns our client, we suggested that our client move the money as a bulk transfer. We would have signed an actuarial certificate to transfer the money to the client’s preferred alternative - NEST. But because NEST cannot receive transfers from other schemes, the money is to be transferred to another mastertrust with what the client considers a less attractive default fund with a higher charge than NEST”.

Henry Tapper, Director First Actuarial.