

Financial Services Consumer Panel

AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Telephone: 020 7066 9346
Email: enquiries@fs-cp.org.uk

Madaliso Zgambo
Department for Work and Pensions
Policy Group
Private Pensions and Arm's Length Bodies
Directorate
Third Floor South
Quarry House
Leeds
LS2 7UA

19 August 2020

By online response form:
https://getinvolved.dwp.gov.uk/05-policy-group/review-of-the-default-fund-charge-cap/consultation/confirm_submit

Dear Mr Zgambo

The Financial Services Consumer Panel's (the Panel's) response to the Call for Evidence on the Default Fund Charge Cap and Standardised Cost Disclosure

The Financial Services Consumer Panel is an independent body established by statute to advise the Financial Conduct Authority (FCA). We represent the interests of individual and small business consumers in the development of policy and regulation of financial services in the UK.

The Panel is pleased to be able to comment on this paper as it has long-advocated for greater transparency of costs and charges in the pensions and investments sector in particular. The Panel's own research¹ into cost and charges disclosure demonstrates the complexity in this area and the great need for clarity, consistency and simplicity to ensure good consumer outcomes.

While the intentions of extending the fund charge cap to some or all transaction costs are sound in theory, we would not want this to limit the flexibility the fund manager has to make decisions that ensure the best outcomes for scheme members.

Having been members of the Institutional Disclosure Working Group that recommended the widespread use of costs templates, we would hope that voluntary uptake would continue across the board, given its benefits, meaning legislative intervention should only be needed if uptake slows down, or scheme coverage is low.

¹ https://www.fs-cp.org.uk/sites/default/files/fscp_final_discussion_paper_investment_costs_20160229_4.pdf

Yours sincerely

Wanda Goldwag, Chair Financial Services Consumer Panel

Consultation Questions

Q1: What are the advantages or disadvantages of extending the cover of the charge cap to include some or all transaction costs?

We understand that transaction costs can be material to the overall consumer value when investing in funds. Somewhat confusingly, for consumers, this impact can become proportionally higher (as a percentage of all fees) when the fund AMC is lower.

We are not aware of evidence of incentives on fund managers to incur high transaction charges through over-trading². We also appreciate that transactions, and their associated costs, can be initiated by events out of the control of the fund manager – such as unexpected levels of market volatility, or member related fund outflows.

Whilst it is clear the inclusion of all transaction costs within the cap would provide better assurance as to the ex-post charges that would be borne by the members of a scheme, we have concerns that such a cap could create additional complexity (for both the fund manager and the consumer) and perversely could reduce consumer outcome by limiting the fund manager's ability to manage the fund as they intend (to deliver the best returns for the members).

Any limitation of the fund manager's ability to execute their strategy could become of specific concern in periods of market turbulence where limiting the fund manager could lead to (otherwise) avoidable losses being incurred within the fund or opportunities to increase returns being missed.

Furthermore, the unpredictability of transaction costs (hence the already observable spread between ex-ante and ex-post costs) would make it difficult for the fund manager to know, with any certainty, whether a course of action was 'affordable' within the cap midway through the accounting year.

We therefore believe that any control needs to be carefully designed with results benchmarked to enable consumers, IGCs and commentators to scrutinise and understand these costs in the context of the overall value delivered to the investor. This could also better inform decisions about future caps or interventions.

Q2: What would be the impact on scheme member returns/industry if some or all transaction costs were covered by the cap?

This is impossible for the Panel to forecast with certainty. However, the FCA's own data indicates that the average fund charges plus the average negative transaction cost is likely to be below the current cap of 75bps. Therefore, for the average (and we assume majority of) schemes, unless the cap is reduced there is unlikely to be an impact in the normal running of the fund.

² No findings in either the FCA Asset Management Market Review or LCP's Investors are in the Driving Seat Investment Management Fees Survey August 2019

Our concern is that in times of extreme market volatility the decisions of the fund manager may be limited or altered by the consideration of the level of transaction costs that can be incurred, irrespective of the performance outcome that could otherwise be achieved.

With the current (and potentially increased³) focus on value for money by IGCs, we believe the transaction fees could be controlled via this approach being more finely tuned to the overall value being delivered.

Q3: Should there be a combined transaction cost and charge cap, or should these be separate?

No comment.

Q4: Who should be responsible for complying with a transaction cost cap?

If the transaction cost cap were to be implemented we believe the fund manager should be responsible for complying with the cap and the IGC should additionally be responsible for ensuring that the fund manager(s) have complied with the cap.

This approach would enable IGCs to assess the fund manager's compliance with the cap and also fully understand the trade-off in terms of the returns missed or losses not-avoided in ensuring the cap was not breached. We would expect this analysis to feed into their ongoing assessment of the performance of the fund manager, and also any assessment of effectiveness and impact of the caps themselves.

Q5: If we lowered the cap, what would be the impact on (a) scheme member outcomes (b) industry?

We are supportive of any reduction in fees, which in return will increase the value (and therefore net performance) of the fund. However, we would not expect this to be at the expense of gross performance 'missed' due to potential value-adding transactions being unaffordable as the fund managers attempt to limit costs within the cap.

Q6: How have investment approaches altered as a result of the introduction of the cap? What changes have there been in asset allocation, management style (active, passive, factor based)?

No comment.

Q7: Have schemes changed administrator or asset manager in response to the cap?

No comment.

Q8: What links have you found between cost and performance?

No comment.

Q9: How much notice should be given for any reduction in the cap?

No comment.

Q10: Do you agree with the suggestion to incorporate new conditions into flat fee structures? If not, what other ideas do you have to address the effect flat fees can have on small dormant/deferred pots?

³ FCA – Driving value for money in pensions. CP20/9, June 2020

We agree that the current flat-fee approaches can significantly disadvantage members with small pots. Moreover, as you have identified, many of these savers could have the balance in their pension charged out to zero before they reach retirement, even with a reliable annual investment return. Potentially, each successive deduction of the flat fee has an increased impact on the remaining funds.

We are therefore supportive of any new conditions that better align the impact of a 'flat fee with a percentage charge' with the impact that a solely *ad valorem* based fee would have.

Additionally, we note the example, accepting it is for illustrative purposes, has the lower limit for any fee to be charged to be £100. Our expectation is that:

1. The flat fee plus the percentage of funds charge, in total, would for all pot sizes fall beneath the level of the charge cap applied to ad-valorum charges based funds.
We understand the benefit that a flat fee structure can have for new market-entrants and smaller-sized providers, but this should not be at the cost of the scheme members' returns,
2. The starting point for flat fees to commence is higher than the £100 in the example, as this is, in effect, the backstop for the members funds. By switching to an ad-valorum only fee below the starting point the reduction in the overall fund value (if any) is slowed, hopefully ensuring the member has some balance remaining upon retirement.

Q11: Should any approach to limit flat fees apply for all scheme members with a pot below certain sizes, or only for deferred scheme members? At what level should the limit apply in each case?

The approach to limit flat fees should apply to all scheme members with a pot below a certain size.

We have no specific view as to the level at which this should be set. However, we would suggest an approach where:

1. The lowest level of flat fee is easy to understand (a round figure) and significant enough that the member will notice it in their annual statement
2. The level of flat fee plus the ad-valorum charge is below the charge cap for ad-valorum only based schemes, for all pot sizes.

Q12: Are you aware of any issues that would make it difficult to implement this kind of mechanism to limit flat fees, in particular, in relation to the broader issues around the desirability of consolidating small dormant/deferred pots?

No comment.

Q13: What would be the impact on scheme members/industry?

No comment.

Q14: Is legislative intervention required to support the uptake of the CTI templates?

We would hope that the benefits associated with the use of the templates would drive take-up and therefore legislation should not be required. However, if this is not the case and uptake is slow, or scheme coverage low, we would support the proportionate

legislation to encourage use and therefore boost the ease of value for money comparison which will benefit scheme members.

Q15: How easy is it to request cost information from asset managers?

No comment.

Q16: Do you believe that scheme members and recognised trade unions should have the right to request the information provided on the CTI template, and that a requirement to disclose this on request is proportionate?

The Panel believes that transparency and openness across all aspects of a product helps consumers understand the product, its features and performance, and therefore make better decisions and achieve better outcomes.

In addition, in workplace schemes this transparency and openness can enable scheme members to better understand the decisions that have been, and are being, made on their behalf.

We would therefore support the right of consumers (scheme members) and trade unions to request the information provided on the CTI templates. We note that the User Summary template is likely to be more easily understood by scheme members than the Main Account Template and would therefore support the right to request this as a minimum requirement.

We believe the obligation to provide this is proportionate.

Q17: Should DB schemes be required to adhere to the same standards?

As the benefit in DB schemes is defined we do not see a direct benefit to members in requiring DB schemes to adhere to the same standards.

Q18: What are the barriers to using the information obtained when making decisions?

No comment.