Department for Work & Pensions

**GUY OPPERMAN MP**
**Minister for Pensions and Financial Inclusion**

HM Treasury

**JOHN GLEN MP**
**Economic Secretary to the Treasury**

Rt Hon Frank Field MP
Chair, Work and Pensions Select Committee
House of Commons
SW1A 0AA

29 April 2019

Dear Frank,

At our Committee appearance on the 3rd April, we promised to follow up in writing on a number of issues of interest to the Committee. In order to respond to the Committee's queries, we are writing to set out where the responsibility lies for delivery of value for money in the different types of pension schemes, and what Government is doing to deliver value for members.

You also asked about use of the Pension Wise website, the impact of pensions scams, and pensions tax relief. We also wanted to clarify some points on financial advice.

Our response to these points is set out below.

**Value for money**

Broadly speaking the value for money in a defined contribution scheme is the risk-adjusted, long-range return, net of costs. Research has suggested that net returns and risk are the key things which inform members' evaluation of value for money.

There is a trade-off to be struck here. For a higher long-range return, members will need to take more risk. That will mean more volatility in the value of their pension pot on their pension journey – but memberships will have different attitudes to risk, and may be able to tolerate more or less volatility in the value of their pot. There are also other things members value to a greater or lesser extent, such as the quality of communication, whether there are online tools to help them model outcomes, whether the scheme invests in line with members' values or not, and so on. Some employer sponsors of pension schemes opt to pay some or all of the members' charges, which also enhances value for money.

This is why Government is not prescriptive about an absolute definition of value for money; it will vary with the membership. Risk adjusted returns are a key consideration, but trustees need to identify what else their members value, as best they can, and assess the value they deliver against that.

**Delivering value for money**

For trust-based occupational schemes, trustees (or managers, in the case of public service pension schemes) are responsible for oversight of occupational pension schemes. They have a fiduciary duty in trust law to act for the purposes of the trust, which is often expressed as an undivided loyalty to the best interests of beneficiaries (that is, the members).

In summary, the responsibility for delivering value for money for members of occupational schemes sits with trustees (or managers).

In addition, trustees of defined contribution occupational schemes have a legal duty to calculate the levels of charges and, as far as they are able, transaction costs, and to report on their assessment of the value for members these charges and costs represent. The Government legislated in February 2018 to require occupational DC schemes to publish their assessment of value for members; and all schemes will have published their assessment by November 2019.

We anticipate that giving DC scheme members ready access for the first time to information on all the costs and charges they bear will address long-standing concerns over hidden costs, and assist members in making decisions about where they consolidate historic pension pots.

For workplace personal pension schemes, in 2013, the then Office of Fair Trading found that the governance that providers had put in place on the ‘contract-based’ side of the market was often not sufficiently independent and may not take into account all the key elements of value for money. In response, the FCA legislated for Independent Governance Committees (IGCs) to consider and report on all of the key elements of the value for money of schemes. The FCA is currently consulting on a number of measures related to IGCs, including extending their remit to report on firms’ policies on environmental, social and governance (ESG) issues and provide oversight of the value for money of investment pathways.

Employers have slightly different priorities; they have a legal duty to provide members with a pension scheme. Many employers take that duty very seriously, and do significant due diligence. But we recognise that not everyone can or will want to do that, which is why the government and the FCA have set minimum standards for all workplace DC schemes, around governance, charges and transparency.

In the decumulation phase, last year the FCA published its Retirement Outcomes Review, a two-year study of the retirement income market following the introduction of pension freedoms. The FCA has proposed a number of measures to improve consumer engagement and transparency and comparability of charges on income drawdown products. Some of these measures will come into force later this year, and the FCA has recently consulted on measures related to investment pathways.

**Oversight of the investment chain**

In occupational DC schemes, the vast majority of trustees invest via an investment platform in funds. The trustees of the DC schemes are overseen by the Department for Work and Pensions and The Pensions Regulator (TPR). Investment platforms and fund managers are overseen by the Financial Conduct Authority, with HM Treasury as the responsible government department.

In contract-based schemes, the provider – often an insurer – invests in the same way, via a platform in funds. In this instance, all three market participants are overseen by the Financial Conduct Authority.

TPR has a variety of tools at its disposal in overseeing the value for money delivered by pension scheme trustees and the costs borne by members.

- Pension schemes are required to certify annually that they have completed the Chair's Statement and, where the scheme is used for automatic enrolment, that they are compliant with the charge cap.
- TPR has broad information seeking powers to obtain information where it has reason to believe that trustees have not complied with these requirements.
- TPR also carries out regular surveys of pension scheme governance (see next section) and has carried out a thematic review on value for money statements in small and micro pension scheme. It plans a review of default investment strategies later this year.

**Government's view of value for money**

You asked about Government's role in checking that our interventions were working, and trustees were delivering value for money.

In relation to the charge cap, Government published the results of charges surveys in 2015 and in 2017. The most recent charges survey found that average charges faced by members of DC schemes used for automatic enrolment were between 0.38 and 0.54% depending on scheme type, well below the level of the charge cap.

In relation to governance and the value for money statement, The Pensions Regulator regularly surveys the governance of DC schemes and publishes the results in its DC schemes surveys. Last year it found high levels of compliance with the largely non-statutory Key Governance Requirements amongst larger schemes, but significantly weaker governance amongst many of the smallest pension schemes.

We would re-emphasise Charlotte Clark's point that the vast majority of members are in larger schemes. Less than 1.5% of members are in schemes with fewer than 1,000 members. However, we are mindful of issues at the bottom end of the market. This is why the consultation referred to in the Committee evidence session, "Investment Innovation and Future Consolidation", not only includes proposals to remove barriers to investment in illiquid assets, such as housing and infrastructure, it also requires smaller schemes to consider at least every 3 years whether members might receive better value in a larger pension scheme.

Although that consultation has now closed, officials would be pleased to receive any further thoughts from the Committee, whether ahead of or as part of your formal report. I enclose a copy of the consultation for the Committee.

**Pension Wise statistics**

In the first full year of the Pension Wise service (2015/16) there were 60,939 appointments. In 2018/19, there were 167,654 appointments; a 180% increase.

These figures do not include visits to the Pension Wise website, of which there have been more than 8.5 million since the service launched in 2015.

Demand continues to increase and resources are in place to make sure that the service can keep up with further growth in 2019/20.

**Pension Scams and Project Bloom**

The Committee were also interested in the impact of pension scams on people last year. Action Fraud routinely collates information about pension and other types of fraud from a number of sources. Its information shows that the average loss for a pension scam victim was £91,000 and the average loss as a result of an investment related scam was £29,000. As the Committee will appreciate, one of the key barriers to gathering reliable data on pension scams is that people may not know they have been scammed until several years after the event or they are reluctant to report being deceived by a scammer.

The scams awareness campaign we ran jointly last year with the Pensions Regulator and the Financial Conduct Authority was highly successful and resulted in a significant increase in scams being reported to Action Fraud. In addition, the campaign helped warn 370 people who called the Scam Smart service that the firm they were talking to was unauthorised, which helped keep their money safe. We estimate that as much as £33 million might have been saved from falling into the wrong hands.

**Pensions Tax Relief**

The Committee also asked two questions concerning the provision of pensions tax relief: one was a suggestion from the Chair about dividing the cost of pensions tax relief among savers, and the other concerned the number of people with earnings below the personal allowance contributing into a pension scheme via net pay tax relief arrangements.

On the suggestion of dividing the cost of pensions tax relief among savers, the proposal was that that each individual received an equal proportion of the total cost of tax relief, rather than it corresponding to their level of income tax due. As you will be aware, at Summer Budget 2015 the Government conducted a consultation on whether there was a case for reforming pensions tax relief to strengthen incentives to save, and offer savers greater simplicity and transparency, or whether it would be best to keep with the current system.

The Government approached the consultation with an open mind, rather than putting forward specific proposals for reform. The Government was clear from the start that the conclusion of the consultation could be that maintaining the current system remains the best way of ensuring that individuals are supported to save.

Some responses to the consultation proposed models that provided a flat rate of tax relief, and the viability of these models was assessed at the time. Overall, however, responses to the consultation indicated that there was no clear consensus for reform and so at Budget 2016 the Government announced that it would not be making fundamental reform to the pensions tax system at that time.

The Government has made some more modest, but important, changes. From 6 April 2016 we restricted the annual allowance on tax relieved pension savings for those with an income over £150,000. At the same time, we reduced the lifetime allowance for tax relieved pension savings from £1.25 million to £1 million. In order that this benefit is not eroded over time, from April 2018 the lifetime allowance has increased in line with CPI. This means for 2018-19 the lifetime allowance increased to £1,030,000, and has risen to £1,055,000 from April 2019. These changes allow savers to continue to make significant pension savings tax-free while ensuring the sustainability of public funds, and that incentives to save are targeted across society.

All aspects of the tax system are kept under review and are subject to change through the annual Budget, in the context of the wider public finances. Any future changes will be announced through this process.

On the number of people with earnings below the personal allowance contributing into a pension scheme via net pay tax relief arrangements, HMRC's most recent data show that for the tax year 2016/17, there were 1.33m such individuals.

For the tax year 2018/19, those with earnings below the personal allowance and contributing at statutory automatic enrolment rates would have seen a difference of up to £35 per year between net pay and relief at source tax relief arrangements. For 2019/20, this will have increased to around £65 as the automatic enrolment contribution rates have risen.

Further, we would like to clarify that it is the raising of the personal allowance above the automatic enrolment earnings trigger, that has largely created this situation, and not the increase in average earnings as was stated in the evidence. However, it is important to remember that the change to the income tax threshold has meant that 1.74m people on the lowest incomes will have been taken out of income tax altogether since 2015-16.

**Financial Advice**

We want to clarify comments made to the Committee regarding FCA bans on those operating in financial services. Ruth George MP asked how the Government is engaging the FCA to do more to identify cases of poor advice and take stronger action. Part of the answer noted that the FCA had implemented 50% more bans than previously. We want to provide a fuller explanation of the ban referred to and clarify the figure used.

Where the FCA decide that people are not fit and proper they can take action to prohibit them from the regulated financial services industry, even where their conduct took place in an unregulated area. These prohibition orders may also be colloquially referred to as 'lifetime bans'. The regulator is not seeking to punish the individual for misconduct, but rather are taking protective action to stop individuals from causing harm in the future. The FCA can take this type of action where they decide, for example, an individual lacks honesty and integrity, or competence and capability. For a successful prohibition there must be evidence that the individual, on an ongoing basis, is not fit and proper.

The number of prohibition orders have increased in recent years. There are two ways to measure these figures. In terms of calendar year, the FCA issued c.70% more people with a prohibition order in 2018 compared to 2017 – in real terms increase of 24 people in 2018 compared with 14 in 2017. In terms of the financial year, the FCA issued prohibition orders to 20 people in 2018/19 compared to 19 people in 2017/18. However, regardless of which numbers are used, the point remains the same: the FCA has strong powers to tackle bad practice, and that the regulator utilises these powers to protect consumers.

We also wanted to take this opportunity to highlight that the Senior Managers and Certification Regime (SM&CR) will apply to financial advisors from December this year. The SM&CR is a regime implemented by the FCA which aims to make individuals more accountable for their conduct and competence in financial services. This extension of the SM&CR will significantly strengthen the FCA's powers to tackle unsuitable or negligent financial advice.

Thank you for inviting us to give evidence. Whilst we and our predecessors have done much to address issues with pension costs and transparency, we recognise there is always more we can do. We look forward to hearing your recommendations.

Yours sincerely,

**Guy Opperman MP**
**Minister for Pensions and Financial Inclusion**

**John Glen MP**
**Economic Secretary to the Treasury**