Check Against Delivery

THE DEFINING CHALLENGE OF OUR TIME

Good afternoon. It is a great pleasure to join everyone for today's important, and topical conference.

As we're all well aware, we're now only a matter of weeks – or days even – away from arguably the most profound political reform of UK pension provision since Beveridge in the 1940s, and universal coverage.

So, for policy and business leaders here today, this is clearly a critical period of change, and certainly one that will define our professional lives over the coming years.

It's also, frankly, unchartered territory. Not just for the domestic pension industry, regulators or politicians.

But also, importantly, for those now approaching retirement, who will have a very different pension experience to those of their parents. More choice and flexibility, certainly. But also potentially far more significant decisions to take.

So there is, understandably, an element of unpredictability here over what the future holds. For some, we're on the threshold of significant opportunity. Others see risk.

But the reality for those at the centre of this change – in particular, policy makers and firms – is that we've moved well beyond the point of Socratic debate over direction.

What matters now is simply: delivery, delivery, delivery. How effectively are political principles applied in practice? How well are consumers supported under the new regime as we move things forward?

And, importantly, how do we accomplish all this in the context of an industry that is, like no other, dominated both by past complexity and future uncertainty?

So, on one hand here, you have customers entering retirement today with policies affected, over the course of many years, by multiple waves of reform and change: often pre-dating man's landing on the moon.

On the other, you have wider challenges linked to the most complex societal trends and behavioural issues.

So, policy makers 20 years from now, particularly in countries like the US and UK, look likely to be dealing with the effect of a world that appears to struggle to save, or make decisions based on far off events.

And of course, we know this, in turn, will be affected by wider shifts in society, particularly a maturing demographic. So, even as we're putting aside less, we're ageing more. In the UK by some five hours a day. While globally, the forecast here is for a 244pc increase in the number of over 85s in the next 35 years[1].

Now, few are seriously predicting these trends will slow. Indeed, the smart money is on a rapid acceleration in longevity. Many scientists are already confidently predicting that the advent of 'gero-protector' drugs, and the like, will have a profound impact on the ageing process.

So, whether we look to the past, or to the future for context, the conclusion is much the same. We're in the middle, as the ABI argued last month, 'of one of the defining' challenges of our age[2].

[1] ABI - *Retirement 2050 report*
[2] ABI – *Retirement 2050* report

And for me, the particularly interesting question here, and the one I want to look at specifically this afternoon, is this: who ultimately has responsibility for meeting this challenge?

Historically at least, accountability has always rested firmly on the shoulders of leaders, in government, as well as in regulation and industry.

But how, if at all, do the new pension freedoms, affect all this? Certainly, there looks to be more pressure on industry today to ensure policy holders receive as much of the returns on their investments as possible.

There is also, rightly, a broad (and important) responsibility here on the FCA to protect consumers across the arc of adulthood: from first contribution to final pension payment.

But, of course, one of the most significant features of the new policy landscape is that it is effectively a self-selection model, which means it is underpinned by an equation of responsibility that, frankly, we’ve never seen before.

Political responsibility certainly, as well as industry and policy making. But also, crucially, consumer responsibility.

And, this afternoon, I want to touch on all three and set out how they appear to us. So where does one begin and the next end? And what are the opportunities here, as well as the risks to manage?

THE FIDUCIARY OBLIGATION

Let me start with the industry responsibility, which has, of course, always been a feature of the market. But where the context has evolved considerably over the years.

So, if you look at the pension environment, specifically, we are clearly in a very different place to, say, 30 or 40 years ago. These were periods of relatively low employment churn, where a pension was seen by employees as an essential, and valuable workplace benefit.

And this, in turn, encouraged firms to take a more rigorous, paternalistic approach, if you like, to managing their pension schemes. So trust based and defined benefit schemes thrived.

Today, by way of contrast, we're in this situation where a significantly more mobile labour force and greater understanding of longevity, coupled with general societal issues over disengagement on pension policy, delayed gratification and so on, means there's generally less pressure applied on firms by their employees for pension benefits.

The result here is two-fold. First, we've seen this transformational shift from DB to DC and from high employer contributions to much lower ones.

Second, those offering, or arranging workplace pensions do not, frankly, live under the same existential threat as their predecessors. There's less pressure to perform from employers, so questions over charges, basis point differences between 0.5pc or 1pc say, suddenly look far less confronting priorities.

Now, this, of course, is a particular worry today because as returns to investments fall, small differences in charge rates become correspondingly more important to employees final pension pot, as indeed they should be important to those managing these funds.

So, the first responsibility here – as, in fact, the NAPF has been working on through its leadership in areas like the Pension Quality Mark – is effectively one of good governance. And it’s one that rests firmly on the shoulders of pensions firms, contract based schemes, and occupational schemes trustees.

Clearly, the situation you have at the moment, where something like £30bn of contract, and bundled trust-based assets in workplace pension schemes, are estimated to be at risk of being poor value for money[3], is an unsustainable one.

Add to this, the fact that there’s often a lack of capability here, so in occupational, or employer organized contract-based schemes, a firm’s trustees may be professional engineers, say, or advertising executives, not pension experts – and you quickly run into some very significant concerns over quality standards.

So what we have today, effectively, is this situation where trustees and Independence Governance Committees, have now become a core political and regulatory imperative – underpinning much of the broader pension reform work around us, particularly auto-enrolment.

Last week, as a topical example, we had a discussion paper published looking at how you could standardize Transaction Costs Disclosure, highlighting the opacity of charges facing IGCs, and trustees, across some 40 individual transaction and uncapped investment fees.

On top of this, you have FCA rules that place a requirement on firms to both assess and, importantly, raise concerns about value for money on behalf of scheme members.

Finally of course, there’s been much greater focus on areas like quality of governance oversight for trustees, with minimum standards coming in. While all

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[3] OFT study - 2013

workplace pension schemes also have new rules on those consultancy charges, active member discounts, commission and charge caps and so on.

So, clearly a great deal of activity here. But it's an imperative for industry to positively engage on both the spirit and the letter of these reforms. To treat this fiduciary duty with the utmost sincerity, if you like.

And certainly, the FCA will be offering practical support and guidance to IGCs over the coming months (particularly those without technical expertise) to effectively manage funds for their policy holders up to the point where they then use their new freedoms.

PENSION FREEDOMS – CONSUMER RESPONSIBILITY

And this brings me to that core issue of consumer responsibility: the self-selection model and how people choose to use their pension flexibilities.

At the centre of this debate, clearly many enormously significant questions for society. Indeed for policy leaders today, these are perhaps *the* most significant questions faced in a generation.

The first, and maybe the most pressing, is simply this: what will be the fundamental purpose of workplace pensions from April? Not a question UK policy makers have ever had to confront before due to the nature of annuities. But one that is now very immediate.

So, come April do we see pensions in the traditional, post-Beveridge context, as being there to alleviate poverty in retirement? Or are they, as now, a replacement rate for working age income? Or perhaps increasingly, for many, they become used to clear debt? Or to make property purchases?

And how, importantly, are all these questions themselves affected by the societal changes around us? The increasing numbers who've lived and spent their way through the first great age of consumerism. The broad switch from DB to DC. Reduced savings ratios. Higher expectations of living standards and so on and so forth.

These are all, of course, profoundly important questions. Certainly, under the system as it will be, there will be no ability to prevent all of the people, all of the time from making 'sub-optimal' decisions.

Some savers, come 55, will invariably head to Las Vegas, buy fast cars or otherwise calculate how to run down their pension pots in days and months, rather than years.

Optimists will be inclined to believe that these numbers will be fractional. Pessimists that they may be more significant. Indeed Saga seems to have suggested that cruise bookings have already risen by some eight percent ahead of April.

But the reality is that this is all simply part of the process that flows from the benefit of freedom. Some responsibility, by definition, has to bump across from industry to customers. Otherwise you simply return to difficult conversations around why policy makers should, in effect, decide how savers draw their money.

The challenge here, however, is one of degree. So to what extent does that responsibility bump across?

And it is perfectly reasonable I think for firms to question: where accountability eventually lies if you end up in a situation, say, where X or Y percentage of consumers refuse to listen to any guidance or risk warnings given?

Who, ultimately, is to blame if – ten to 15 years on from now – those people regret whatever choice they've made, or complain they weren't properly guided?

And actually at that point, it becomes difficult to sensibly argue that individual consumers shouldn't accept responsibility. Nor, I think, would wider society expect otherwise.

But there are still wider issues for policy makers over what all this means in terms of provision? Do trustees want to provide the flexibilities? Will advisers and providers want to take the regulatory risk they see and so on and so forth?

And understandably, as we approach April, there is some industry anxiety here, particularly over issues like liability – and how far providers need to go to warn consumers. Or prevent them from making choices that they believe are against the consumer's best interests.

CONSUMER PROTECTIONS AT RETIREMENT – A JOINT RESPONSBILITY

And this is where the policy making responsibility kicks back in for the FCA. Indeed, we've already seen important guidance issued on where liability begins and ends for firms.

But the core challenge here of course, is successful delivery of the Guidance Guarantee, along with retirement risk warnings.

Now, the FCA role here is carefully set out – but important because it effectively underpins all of today's pension reforms, with an infrastructure of protections and support that follow savers from the minute they enter the workplace, to the moment they begin to consider what they do with their pension.

So, on the one hand, there is FCA industry focus here on areas like standards and conduct.

On the other, significant support for consumers through areas like the charge cap, risk warnings and so on. So, those who draw out their pensions under the new freedoms, will be in a position to make what are, clearly life-influencing decisions on future income, with some confidence that the structure behind their choice is sound.

It is worth reflecting here, however, that there is a strict delineation of responsibilities between agencies. So, what you will have, effectively, is the FCA setting the standards, monitoring compliance and collecting the levy to fund provision.

It will not however, regulate the provision of Pension Wise. HMT, which has overall accountability for delivering the pensions guidance service, including deciding broad approach, setting aims and acting on recommendations from the FCA.

So, come April 6, what you will have is a structure under which customers will, on seeking access to their pensions, immediately be recommended to seek guidance – via Pension Wise or financial advice.

After which, when a decision has been made, the system will effectively have a further check, if necessary triggering a personalized risk warning. Allowing a final opportunity for people to assess the wisdom of their choice.

Effectively then, what we're describing here is a division of responsibility between consumers, firms and policy makers that is a long way from today's annuity-based system.

All of which presents significant opportunities, for sure. And certainly, it looks as though there is appetite here among policy holders to use their new freedoms. While, interestingly, we're also beginning to see firms – including online investment platforms – advertising in this space[4].

REDUCING FRAUD RISK

But, as yesterday's Work and Pensions Committee report laid out we deceive ourselves if we imagine there are not also risks here for firms and policy makers to manage.

One of the most important, for me, the possibility that some customers in this first tranche to benefit from the new freedoms, will be targeted by criminal enterprise. Scams and fraud, we know, tend to proliferate at the moment of maximum uncertainty.

So, for the pension industry, the upcoming switch in regime looks something akin to a Y2K moment. Particularly given that there'll be a significant number of people who've held off crystallising their pensions over the last year in order to take advantage of the new policy landscape.

It is an imperative that this risk is properly managed and mitigated. Otherwise, you clearly enter potentially very difficult territory. Policy holders, for example, being enticed to invest in scams by high returns in a low return environment.

Or, indeed, the possibility that firms target consumers, before they hit 55, with pension liberation scams, persuading them to access their money before the rules allow access. A particular risk, given that many of those approaching retirement today will – unlike their parents' generation –be carrying debts with them.

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[4] Nutmeg – advertising on billboards in London on potential to use pension pots and investments in their funds.

So, clearly some important challenges here to manage. But whether you believe in freedom of choice, public paternalism or in some combination of the two, the presence of risk is, frankly, unavoidable. It exists even now.

And certainly, there is no appetite – at either end of the political spectrum – for the context to remain as it is today.

CONCLUSION

The great unknown, of course, is what April and the years ahead will bring for all of us. What choices will customers make? Will the annuity market be as affected as some are predicting? Or will it, as others argue, still hold an attraction for policy holders as a replacement rate?

And, for firms, on a more prosaic but important level, how effectively will the challenge of preparing for the new regime be managed in terms of core areas like IT upgrades and communications?

These are all defining issues in what is, for all of us, a defining period. And time will, very soon, tell how this new balance of responsibilities plays out.