

# Disclosure of costs, charges and investments in occupational pensions



Response from NEST Corporation

## Executive summary

We're pleased to contribute this response to the Department for Work & Pension's (DWP) consultation on the disclosure of costs, charges and investments in occupational pensions.

### Costs and charges

The pensions and investments industry has made a great deal of progress over recent years in bringing down costs and charges and disclosing those costs. We see this consultation as a timely contribution to this process – formalising and standardising how fund managers disclose costs and charges to pension schemes, and how pension schemes disclose costs and charges to members.

We strongly agree with and welcome the DWP's acknowledgment that information around costs, charges and investments must be understandable and useful for members. We agree that, unless it is set in context, this information may have unintended and adverse consequences on members' decision making. We believe the approach proposed in the consultation – to avoid being overly prescriptive in how schemes present the information – is sensible. This will allow schemes to consider any unique features of their investment strategies when contextualising the information. It'll also give them scope to present and explain the information in a way that matches their members' financial literacy.

NEST was established to provide a low-cost scheme and we strongly believe that as a rule, lower fees and costs, all else being equal, mean better member outcomes. We also believe that optimum value for money, rather than lowest absolute cost, should be the focus of regulation and trustee due diligence. In the past, some of the investment management fees paid by pension schemes have been excessive, and many of the transaction costs arguably avoidable. Improvements have been made throughout the value chain and there are no doubt further improvements to be made. But we believe trustees should be mindful that in certain circumstances, markets and asset classes, higher costs and fees are unavoidable and are justifiable in achieving better risk adjusted returns for members.

We also welcome the DWP's acknowledgment that transaction costs can be challenging to measure and difficult to predict in advance. In particular, we'd agree there are certain costs, such as asset servicing in real estate, that are more accurately a cost of doing business rather than a transaction cost or drag on performance.

Measuring and reporting costs and charges can serve the agenda of establishing value for money and holding providers to account, without becoming the only or most important frame for investment decision making.

### Disclosure of investments and funds

With regards to telling members where their money is invested, we believe transparency and candidness is critical to building members' trust and confidence in their provider and in the benefits of saving for a pension. In addition, this information will sometimes be necessary to help members make investment decisions. With that said, the overwhelming majority of members stay in their scheme's default fund and engagement with pension saving is very low. We strongly believe that all information regarding members' investments should be framed in a way to help them understand the implications of different investment

decisions. Information for information's sake is unlikely to improve members' understanding or engagement. In fact, 'over-reporting' could result in some members feeling confused or anxious about their pensions. This could in turn lead to unintended and adverse reactions such as opting out or switching to unsuitable funds. Schemes must be aware of these risks and have the right to give members details of their investments in a way that takes account of possible behavioural biases and differing levels of financial literacy.

Finally, we welcome the proposals around improving how occupational pension schemes take account of, monitor and report on the environmental, social and governance (ESG) factors relevant to their investments. We firmly believe that integrating ESG factors into the investment process enhances long term risk-adjusted returns and therefore improves pension outcomes for members.

## Responses to specific questions

### Questions for organisations on costs and charges disclosure

**Q01. The proposed Regulations on costs and charges apply to the same schemes to which the existing requirements to assess charges and transaction costs and to prepare an annual governance statement applies currently. Do you agree with this proposal?**

We agree with this proposal.

**Q02. We propose that: The Chair's Statement should be extended to include the actual charges and transaction costs for each default arrangement and any alternative fund choices. Do you agree with this proposal?**

We agree with this proposal. In fact, we already publish details of all explicit transaction costs for all of our default and fund choices in our Chair's statement. We also agree that the information should be framed appropriately. We agree that schemes should have latitude to frame and format this information in such a way as is suitable for their members' level of engagement and financial literacy – as per the proposals in questions 3 and 4 below.

**Q03. We propose that cost and charge information should be: (a) Published annually; (b) The responsibility of the scheme trustees or managers to publish; (c) At the discretion of trustees and managers of where to publish, as long as it is publicly available and can be indexed by major search engines. Do you agree with these proposals?**

We agree with these proposals.

**Q04. We recognise that how the information is contextualised and presented to members is important. We therefore propose: (a) that the 'default investment strategy' and 'Costs and charges and value for members' sections be published to provide appropriate contextualisation to the cost and charges information; (b) that schemes are required to show the cumulative effect of costs and charges over time, as set out in the draft Statutory Guidance. Do you agree with these proposals?**

We agree with these proposals in principle and would emphasise the importance of providing suitable context around the disclosure of this information.

However, we would caution that historic transaction costs are not an effective indicator of the future impact on performance. If historic costs are to be used, we would recommend that the effect of transaction costs are captured either by a multi-period historical average or by some other reasonable, stable, estimate. We don't believe schemes should be required to project forward the cumulative effect of transaction costs based on the realised costs in any one year. For schemes which make allocations to illiquid

assets, transaction costs can be lumpy through time. This means a multi-period average would avoid significantly over or underestimating the likely cumulative effect for the long term.

The DWP has noted in the consultation that ‘£ and pence’ illustrations may give members a ‘false impression of absolute accuracy’. We would recommend schemes use a common hypothetical member, or set of members, so that the only variable between schemes is their own expected costs and charges, rather than second and third order assumptions about salaries, inflation, investment returns, wage growth etc.

**Q05. We propose that a web link to the location where cost and charge information for their pension scheme can be found is given to members as a matter of course when they receive an annual benefit statement. Do you agree with this proposal?**

We agree with this proposal.

**Q06. Is any further guidance or support required to achieve to meet the proposed regulatory obligations in the proposed Statutory Guidance?**

We believe schemes should have the latitude and responsibility to present the information in a way that’s relevant to their scheme’s specific circumstances. However, it may be useful for the DWP to provide an optional disclosure pro-forma for smaller schemes, as a form of guidance in good practice.

**Q07. Do you agree with the proposed penalty regime?**

We don’t have a view on this matter.

**Q08. Do you agree with the proposal that trustees should only be required to provide a hard printed copy if it would be unreasonable for the individual to access the available information published online? Do you have any other evidence or thoughts about how these proposals will affect members of protected groups and what mitigations, if any, may be required?**

We agree with this proposal.

**Q09. Thinking about the current administrative processes undertaken by the scheme, can you give an indication of the additional time/costs of incorporating our proposals into existing process?**

Our current reporting framework is already largely aligned with these proposals so we don’t expect significant further expense as and when they are rolled out. For example, we already publish details of all explicit transaction costs for all of our default and fund choices in our Chair’s statement.

**Q010. Do the draft Regulations deliver our policy intent, or are there aspects which you believe will not deliver our objectives? Do you foresee any unintended consequences?**

We think the proposals set out should deliver on the intent to disclose costs and fees information to members.

However, we’d note two reservations:

1. If the intent of the policy is for members to make more informed decisions, evidence from the UK and abroad shows that the vast majority of members don’t engage with their pension savings and engage even less with the level of information being suggested here. Most do not even read their annual benefit statements. Therefore, it’s unlikely that in many cases providing more information will be the sole solution. In fact, evidence from other markets suggests more information,

particularly if it's not framed appropriately, can serve to confuse and undermine good decision making.

2. Furthermore, in the case of auto enrolment, members themselves don't decide which pension scheme to use, but are enrolled into a scheme chosen by their employer and their employer's advisors. If the broader policy intent is to hold pension schemes to account over how far they offer value for money for members, providing information to members may not be the most effective method. The more appropriate recipients of detailed information on costs, charges and value are first and foremost the Trustees or governance committees responsible for members' outcomes, and secondly the 'buyers' of their services, or in other words employers and their intermediaries.

**Q011. Are there any other proposals in this consultation on which you would like to offer comments?**

We would like the industry and the DWP to be mindful of the differences between low cost and value for money. A sophisticated, diversified investment strategy will likely include investments in assets which by their nature carry higher fees, transaction costs and other ancillary expenses to manage. Any future refinement of regulations around costs and charges should not be to the detriment of DC schemes' ability to access these investments.

**Questions for organisations on investment disclosure**

**Q012. Do you believe that members and recognised trade unions should have the right to request this information and that the requirement to disclose this on request is proportionate?**

Yes. While this information will be beyond the needs or interest of most members, we see no reason why providing transparency on this issue should be particularly onerous for pension schemes. Accommodating the minority of members who might wish to access this information is likely to engender greater confidence and trust in their schemes while at the same time being unlikely to create any significant amount of material detriment. With that said, consumers do tend to demonstrate brand loyalty and/or brand aversion. Pension schemes ought to reinforce the message that it is the scheme, and not any one underlying fund management house, that is ultimately responsible for the members' investment outcomes.

We don't believe, however, that bespoke reports for individual members on their historical exposures to different funds are the right approach. Within dynamic investment strategies, and/or those with lifestyling, this is likely to be confusing to the member and onerous to the pension scheme.

**Q013. Do you agree with the proposed timing and penalties for pooled fund disclosure on request? Do you agree with the policy that trustees should disclose the pooled funds invested in over the previous scheme year? If not, what alternatives would you propose?**

We don't have a view on penalties but we do agree with the principle of annual, or more frequent, disclosure. We already publish (on our public website) quarterly reports that contain details of the underlying third-party funds we use to deliver our investment approach. We believe this is a reasonable framework for meeting the spirit of the proposals set out in the consultation.

**Q014. Do you agree that restricting disclosure on request to only the pooled funds in which members were directly invested is more helpful to members and less burdensome to trustees?**

We don't see that there's necessarily a blanket case for restricting disclosure to pooled funds. With due consideration to operational practicality and any commercial sensitivities, we think schemes should disclose as much detail as will make the information understandable, informative and crucially, actionable. It's important to bear in mind that in most cases, this level of information will not be of great importance for members. However, as per Q10 above, it will be crucial to employers and their advisors when evaluating different pension schemes.

**Q015. Do you agree with our proposed policy on disclosure of top-level pooled funds only, combined with 'look through' of unit-linked contracts and mandates to the 'first tier' of underlying pooled funds?**

Per our answer to question 14 above, we believe that schemes should be given the latitude to exercise their discretion about how to disclose the substance of members' investments – but with a requirement that they err on the side of more transparency rather than less. We believe that restricting the transparency to top level pooled funds is arbitrary. It also creates an arbitrary opacity for many pension scheme strategies which make use of instruments such as ETFs, futures, or use separately managed accounts or who, simply, use 3<sup>rd</sup> party funds for which there is no published information beyond which that scheme might choose to provide.

**Q016. Are there any circumstances where trustees and scheme managers would not be aware and would be unable to obtain information about the pooled funds in which their members are directly invested? If there are circumstances in which they are unaware, please clarify how trustees remain compliant with their fiduciary duties in these scenarios.**

We can't envisage such a scenario. Those whose responsibility it is to operate a pension scheme's investment strategy on members' behalf should require full disclosure from their fund managers as to their underlying investments on a reasonably timely basis. Large master trusts like NEST are particularly unlikely to encounter issues getting the information they need. There are some types of investments where such information may be harder to get, for example, hedge funds but it's unlikely that these would ever be a large proportion of the schemes' investments.

**Q017. Do you agree with our proposal that schemes should give standard information about the availability of further information about pension scheme investments in the annual benefit statement? Are there any reasons why this requirement would be burdensome or undesirable?**

We agree with this proposal.

**Q018. Thinking about the current administrative processes undertaken by the scheme, can you give an indication of the additional time/costs of incorporating our proposals into existing processes?**

Our current reporting framework is already largely aligned with these proposals so we don't expect significant further expense as and when they are rolled out. For example, we already publish information on all the underlying funds that make up our default strategy and fund choices on a quarterly basis.

**Q019. Are there any areas where the regulations do not meet the policy intent?**

We don't believe so, no.

**Q020. Are there any other proposals in this consultation on which you would like to offer comments?**

We would like to stress again, that if the intent of the policy is for members to make more informed decisions, evidence from the UK and abroad shows that the vast majority of members don't engage with their pension savings and engage even less with the level of information being suggested here. Most do not even read their annual benefit statements. Therefore, it's unlikely that in many cases providing more information will be the sole solution. In fact, evidence from other markets suggests more information can serve to confuse and undermine good decision making. The more appropriate recipients of detailed information on costs, charges and value are first and foremost the Trustees or governance committees responsible for members' outcomes, and secondly the buyers of their services, or in other words employers and their intermediaries.