BLACKROCK

19th June 2018

Financial Conduct Authority
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The Pensions Regulator
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Submitted via email to: JointPensionStrategy@fca.org.uk
For the attention of Donald Cranswick

RE: Call for input – Regulating the pensions and retirement income sector: Our strategic approach

Dear Donald,

BlackRock[1] is pleased to have the opportunity to respond to the joint call for input on regulating the pensions and retirement income sector, issued by the Financial Conduct Authority (FCA) and the Pensions Regulator (TPR).

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this consultation paper and will continue to contribute to the thinking of the FCA and TPR on any issues that may assist in the final outcome.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

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[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

Executive summary

BlackRock supports the focus of the consultation and highlights the importance of regulatory support in driving effective outcomes for members of pension schemes in the following areas:

Access to advice and guidance

- Consumers saving for retirement have a pressing need for a wide range of support and guidance throughout their lives. We believe that TPR and FCA should regularly assess their rules to ensure their effectiveness in facilitating access to as wide a range of tools as is necessary to support members in taking decisions on saving for retirement. working closely with the new Single Guidance Body.

Assisting consumers to set effective targets and goals

- While auto-enrolment has been highly successful in extending the coverage of work place schemes, in many cases contribution rates will not be sufficient to secure an adequate or indeed comfortable replacement retirement income. It is essential that people are encouraged to save more than the statutory minimum. Our research shows that consumers do not have the information they need to help them decide how much to save to achieve their retirement income goals. While much industry work has been conducted, consumers will also benefit greatly from guidance from regulators, even on a "rule of thumbs" basis.
- We also believe that employers should be encouraged to put in place auto-escalation schemes, also known as 'save more tomorrow' schemes, to help people save more effectively. Joint TPR and FCA guidance on best practices in this area would be helpful.

Supporting Trustees and Independent Governance Committees (IGCs) in designing effective outcomes for schemes

- Good governance and effective decision making is essential to driving successful outcomes for members. We therefore support the ongoing focus on ensuring trustees and IGCs themselves are fully equipped with the tools they need to make these decisions.
- We appreciate that TPR, in particular, has to await the outcome of the Government's White Paper on DB pension schemes and potential forms of scheme consolidation. We note, however, that whatever solutions are recommended there will be a significant need for guidance to trustees on how they should manage their ongoing liabilities to members alongside any action to consolidate underlying assets or schemes.
- Given the ongoing focus on sustainable investment it would be desirable for TPR and FCA to facilitate trustee and IGC access to information.

Continued support for driving effective default pathways to retirement

- We await with interest the publication of the FCA's Retirement Outcomes Review as we believe this will constitute a critical contribution to developing effective investment pathways into and through retirement.

Responses to questions

1. *FCA and TPR's remits intersect in some areas. Do you see this working effectively, or are there areas where this could be improved?*

It is important to manage these overlaps to avoid confusion in the market. We support joint initiatives in areas where responsibilities interact, coordinated development of regulation, and a common understanding of expected market standards.

2. *Do you agree that the areas we have identified [access to pensions, effective governance and funding, preventing fraud, value for money, supporting good consumer choices and outcomes] are the right ones? If not, which themes would you add or remove from our list? In which areas could the FCA and TPR singly or jointly have the most impact?*

We agree that these are the primary areas but would encourage prioritising access and governance:

- On access, we encourage a broad-based approach which incorporates lessons from behavioural finance as to how people take decisions to save for retirement and the types of action which encourage people to save.
- On governance, we emphasise the importance of education, a diverse skill set, and access to risk management expertise in achieving effective governance.

3. *Given our regulatory remits, what more, if anything, should the FCA and TPR do to support people as they start to save in a pension?*

The introduction of auto-enrolment in the UK has been a resounding success story. Since its introduction we have seen the number of workers enrolled in workplace pension schemes increase to nearly 6.9 million in 2016, and is expected to rise above 10 million by 2020.[2]

Since then, we have seen a number of other reforms to savings and retirement which have been effective in making individuals more engaged with their choices. However, we believe low contribution levels remain the single most important barrier to delivering comfortable retirement outcomes.

We believe that auto-enrolment could be enhanced by increasing employee (and employer) contribution rates. BlackRock is an advocate of *auto-escalation*, whereby individuals pre-elect to increase their contribution rate when receiving any future pay increases, helping them to reach higher contribution rates.[3] Following the success of auto-enrollment, the TPR/FCA could encourage firms to adopt auto-escalation schemes for their employees, taking account of varying degrees of utility across income levels.

Whilst we acknowledge that at this stage mandating such measures is beyond the remit of both the FCA and TPR, there are steps that could be taken to develop best practice and help firms to increase employee engagement and awareness of the importance of adequate contribution rates.

As an example, FCA and TPR could develop or encourage development of 'calculators' demonstrating the link between individual's ability to achieve 'replacement income' in retirement and present-day contribution rates. Alternatively, FCA and TPR could publish best practice for

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[2] UK Department for Work and Pension (2016) Press release -*The number of people saving as a result of automatic enrolment to hit 10 million*, available at: https://www.gov.uk/government/news/the-number-of-people-saving-as-a-result-of-automatic-enrolment-to-hit-10-million

[3] BlackRock (2017) *Planning for retirement: Long-term savings and investment in the UK*, available at: https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-planning-for-retirement-uk-july.pdf

employers to develop such tools internally, or facilitate access to existing ones, to guide employee decision-making and improve engagement with pensions.

These calculators would ideally be interactive and help individuals gain a more intuitive understanding of the principle illustrated in Table 1 below – namely the level of annual contributions employees should seek to make in order to ensure a satisfactory level of income in retirement. This would likely increase employee contributions, or at the very least give employees more grounded expectations of their retirement prospects if they were to maintain present contribution levels.

Table 1: Illustrative required contribution rates to achieve desired retirement income given savings start date

		Replacement Rate									
		10%	**20%**	**30%**	**40%**	**50%**	**60%**	**70%**	**80%**	**90%**	**100%**
Age	**20**	1.53%	3.06%	4.58%	6.11%	7.64%	9.17%	10.70%	12.22%	13.75%	15.28%
	25	1.85%	3.70%	5.55%	7.40%	9.25%	11.10%	12.94%	14.79%	16.64%	18.49%
	30	2.35%	4.70%	7.05%	9.40%	11.75%	14.10%	16.45%	18.80%	21.15%	23.50%
	35	3.12%	6.24%	9.36%	12.48%	15.60%	18.72%	21.84%	24.95%	28.07%	31.19%
	40	4.26%	8.51%	12.77%	17.02%	21.28%	25.53%	29.79%	34.05%	38.30%	42.56%
	45	6.09%	12.19%	18.28%	24.38%	30.47%	36.57%	42.66%	48.75%	54.85%	60.94%
	50	9.10%	18.19%	27.29%	36.38%	45.48%	54.57%	63.67%	72.76%	81.86%	90.95%

Source: Internal BlackRock analysis. Figures shown are for a representative UK citizen. These figures are intended to demonstrate a general principle and should be deemed as illustrative only.

Another example would be to develop best practice for employers on ‘save more tomorrow’ schemes, also known as auto-escalation. In the US such nudge techniques have helped overcome the problem of savings inertia.

‘Save more tomorrow’ schemes aim to ensure that people never have to cut their spending power in order to save more. These simple schemes allow individuals to pre-elect a percentage of any future pay increases for investment into their pension pot. As salaries increase, savings are increased automatically and savers are not forced to make the difficult decision of where and how to cut their spending.

Replicating these schemes in the UK could bolster the successes of auto-enrolment, allowing people to start at the minimum contribution rate with individuals gradually saving more each time they receive a pay rise.

TPR in particular could highlight the importance of increasing contributions to employers, developing best practices for communication with employees.

4. *Is there more scope for TPR/FCA working, either singly or jointly, in this area [of effective governance and funding]? To what extent should the emphasis be on collaboration with a wider group of bodies to improve the advice and services supplied to schemes (e.g. administrators, investment consultants)?*

The quality and expertise of decision-makers is crucial to effective scheme governance and funding. It is important that trustees have the expertise to identify the required outcomes for a scheme and set appropriate objectives, and have the knowledge of the asset allocation decision-making process that follows on from this.

The ability of trustees to adequately manage the schemes they are responsible for is impacted by their governance model; technical expertise and knowledge; resources available to assist them in making informed decisions. and qualitative and quantitative methods needed to assess those decisions.

Trustees need clear information on the performance of investments. This should include explanations of how investments have performed and meaningful attribution to the components that contributed to or detracted from performance.

It would be beneficial if the FCA and TPR could facilitate best practice on the types of questions trustees/IGCs of a well-governed scheme should ask themselves or any outsourced provider focusing on outcomes and understanding of investment risk.

(See our response to question six for our views on investment decision making and appropriate default investment for pension schemes.)

5. *How can pension providers and schemes, employers and other firms in the sector improve the security of the money and data they hold? What role is there for FCA and TPR in further driving up standards?*

No comment.

6. *Are there any further opportunities for FCA and TPR to support the delivery of value for money, either singly or together?*

TPR rightly advises focus on four core areas for Trustees and ICGs assessing value for money: scheme governance, administration, communications, and investments. In each area, Trustees and ICGs should consider the relevant costs, and the benefits members receive in return.

Across all these areas we believe trustees should assess value for money on the basis of a range of quantitative and qualitative factors which can be applied on a case-by-case basis depending on the scheme's specific objectives, membership, and structure.

To support the delivery of value for money, the FCA and TPR could develop and actively promote best-practice guidelines for Trustees and ICGs on the criteria to be taken into account when making value for money assessments.

Investing on the whole is now cheaper than ever. For investment management, we believe two areas in a value for money assessment are investment design, and investment implementation.[4]

At the design phase, there are four aspects to consider:

Firstly, identifying the desired outcome; deciding the appropriate asset allocation will flow from establishing the expected actions of scheme members at retirement.

Secondly, finding the appropriate risk level; overall investment design should be deliberate in determining which risks are taken – assessing the main risks within a portfolio, and making an active decision as to whether there is a benefit to exposing scheme members to this risk.

Thirdly, considering broader trends and regulation. Developments, such as the relative growth of emerging market economies, or regulatory initiatives such as the UK Government's Better Workplace Pensions initiative, have the potential to influence the outcomes and

[4] For further detailed analysis, see BlackRock (2017) *Response to FCA consultation on implementing asset management market study remedies and changes to* Handbook, available at: https://www.blackrock.com/corporate/literature/publication/cp17-18-consultation-on-implementing-asset-management-market-remedies-fca.pdf; and BlackRock (2018) *Guide to value for money: A primer for trustees and ICGs of Defined Contribution schemes*, available at: https://www.blackrock.com/institutions/en-gb/literature/whitepaper/value-for-money.pdf

appropriateness of investment decisions. Trustees and ICGs should carefully consider these changes, and reflect them in scheme design.

Finally, the flexibility of Trustees and ICGs is important to allow their schemes to cater for individuals who have their own investment requirements (for example Environmental, Social and Governance (ESG)-focussed or Sharia-compliant funds).

Once overall design is complete, the next step is to implement a life styling strategy – selecting the right investment building blocks to deliver value to members.

The cost of investing generally increases with 'investment intensity (e.g. moving from a plain-vanilla index investment to more active solutions with dynamic asset allocation and risk management).

This extra cost will be of good value if it is needed by the scheme. The required investment intensity will likely differ for a scheme in the growth phase (where it may not be valuable to incur additional cost for funds actively managing volatility) versus a scheme whose members are approaching retirement (where the extra cost will deliver value in as much as it protects members' savings from market turbulence).

7. *How can FCA and TPR work, singly or together, to ensure that information and advice helps people make appropriate decisions? When are people most vulnerable to taking poor decisions?*

One of the unintended consequences of the abolition of commission payments to financial advisors in the UK's Retail Distribution Review has been a reduction in the availability of advice.

BlackRock is concerned by the scale of the advice gap, particularly for individuals planning to take advantage of pensions freedoms, and the lack of easily accessible default decumulation solutions. The benefit of auto-enrolment is that it recognises the uncertainty many people face when taking decisions on how to save for the future and productively leverages the resulting inertia. The recent introduction of pensions freedoms, on the contrary, requires individuals to make active choices at retirement. Access to simple, consistent help is more important than ever before at this point, especially when individuals are faced with an increasingly wide choice of products.

The risk is that individuals will exercise their pensions freedoms to save for retirement in cash rather than in products designed to provide them with an ongoing income and longevity protection. We believe that there needs to be a continued focus on the provision of simplified advice and guidance to enable advisers to give affordable advice focused on specific needs, without conducting a disproportionately long and expensive fact find.

We believe there is a role for the FCA and TPR to work with the forthcoming SGB to bring forward solutions to assist those unable or unwilling to access other sources of financial advice. For example, a powerful, simple solution such as an online 'decision tree' to help guide individuals through the key decisions, as well as what their options are, at various points throughout the accumulation and decumulation stages of their pension journey.

More generally, whilst the FCA's implementation of the Financial Advice Market Review (FAMR) has made good progress on defining precisely what constitutes 'advice', we feel there is more work to be done on clarifying what constitutes 'guidance'. It is 'guidance' which is needed to cater to the many millions of consumers who will not be able to access traditional 'advice' solutions. The establishment of a SGB is a welcome development, however, empowering the financial services industry to help people make informed decisions, via guidance targeted at specific groups rather than at specific individuals, would be far more powerful, especially if this can be delivered through the workplace.

8. *Do you believe that the macro trends that we have identified are those most likely to drive change across the pensions and retirement sector? If not, what are the trends that matter? Which trends should be the highest priority for TPR and FCA? How will those trends (and any other drivers of future risks and opportunities) affect the areas we have identified?*

BlackRock agrees that all the areas identified by the FCA and TPR in the report are significant factors that will drive change across the sector. We would highlight three additional areas:

i. Sustainability:

The Paris Agreement on Climate Change of December 2015 refocused HM Government's attention on the role financial institutions could play in efforts to fight climate change. The Green Finance Initiative was launched in January 2016 in partnership with the UK Government and the City of London Corporation, bringing together experts to provide public and market leadership on green finance and promote the UK as a global green finance centre.[5] In September 2017, the UK Government set up the Green Finance Taskforce to provide policy recommendations to accelerate growth of green finance and the UK's low carbon economy.[6]

One of the Taskforce's recommendations pertains to pension funds, and in particular for the Government to "clarify that trustees and IGCs should engage with their beneficiaries to understand their beneficiaries' preferences and make investment decisions that are based on these preferences".[7]

As a minimum, the renewed focus from policymakers on sustainability matters in the investments of UK pension funds is making trustees, IGCs and beneficiaries more aware of these considerations.

BlackRock believes that sustainability is a driver of long-term value in companies and in the economy. We further believe that it is important for trustees, along with other asset owners and other entities responsible for managing assets, to have the right tools to be able to make assessments of how the relevant ESG and sustainability factors materially impact their investments. Crucially this means having access to ESG information that is reliable and information-useful. To the extent that the FCA and TPR can facilitate trustee and IGC access to such information, this would be desirable.

With regards to growing assets dedicated to 'sustainable investments' – a policy objective we support – we would emphasise that it is asset owners (and those responsible for those assets, such as trustees and IGCs), who determine the asset allocation parameters of their overall portfolio and specify the investment parameters of any individual investment mandate within their portfolio.

ii. Shift to personal responsibility:

Historically, responsibility for retirement planning in the UK has rested primarily with the State and employers. In recent years, this has begun to change with increased focus on individuals being primarily responsible for their financial future.

While the State pension and employer-run occupational schemes will remain an important source of retirement income for many, the increasing moves from defined benefit (DB) to defined contribution (DC) schemes, as well as fragmented employment patterns in the workplace (such as the growth of the self-employed and the gig economy), mean that responsibility for retirement planning is increasingly shifting to the individual. While many people have previously been able to rely on the combination of state provision and DB

[5] http://greenfinanceinitiative.org/
[6] https://www.gov.uk/guidance/green-finance#green-finance-taskforce
[7] The Green Finance Taskforce (2018) *Accelerating Green Finance*, available at: http://greenfinanceinitiative.org/wp-content/uploads/2018/04/Report-of-the-Green-Finance-Taskforce-1.pdf

schemes from employers, going forward this is challenged by the costs linked to increased longevity.

Further to this, having enjoyed the comfort of being enrolled in a company scheme, many people lack the financial capability to make decisions prior to retirement and are often ill equipped to take responsibility for their financial needs post-retirement.

According to BlackRock's 2017 Investor Pulse survey, take-up of financial advice in the 55+ age group is low, indicating that many in this age group do not properly engage in their retirement financial planning. Over 300,000 people need to make retirement income or annuity purchase decisions each year, but the majority cannot or will not seek the financial advice they need to make this decision. Without professional support, individuals run the risk of inappropriate asset allocation to meet their retirement needs -for example by adopting too conservative an approach, or by drawing down all their retirement pot at once and so potentially attracting a punitive tax charge.[8]

This underscores the need for accessible and affordable advice and guidance solutions, particularly for at retirement decision making, as discussed under Question 7.

iii. Mistrust of the financial sector and lack of consumer engagement

Post-financial crisis, trust in business and particularly the financial sector is still low, despite the reforms led by both the public and private sectors. This in turn raises the risk that individuals choose not to engage with retirement, savings, or investment providers – which is particularly concerning given the shift to personal responsibility noted above.

BlackRock would support any measures taken by the FCA, TPR, and other bodies to alleviate public mistrust in the financial sector.

In particular, BlackRock would encourage further consideration as to whether regulator's responsibilities are solely to promote and enforce proper conduct; or whether they should also include measures to promote and improve consumer engagement and decision-making.

BlackRock's 2017 Investor Pulse showed that 60% of UK nationals surveyed were not considering taking steps to move their savings out of cash and into investments. An additional 20% had considered doing so, but did not do anything about it. 34% of individuals surveyed said a clearer understanding of investments would prompt them to move out of cash.[9]

This demonstrates that there are still shortcomings in the UK regulatory environment. Many individuals would welcome a public authority delivering clear messages on retirement planning, rather than having to rely solely on industry communications. Communications and guidance from the public sector would moreover provide a robust starting point for engaging individuals.

Conclusion

We appreciate the opportunity to address and comment on the issues raised by the consultation paper and will continue to work with the FCA and TPR on any specific issues which may assist in ongoing development of their approach to the pensions and retirement income space.

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[8] See Page 8, BlackRock (2017) *Planning for retirement: Long-term savings and retirement in the UK*, available at: https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-planning-for-retirement-uk-july.pdf - fewer than one in five use an advisor. In the 55-64 age group, only 16% currently use a financial advisor, though 35% have used one in the past. In the 65-74 age group, 18% currently use a financial advisor, through 35% have used one in the past.
[9] BlackRock (2017) *Investor Pulse: UK*, available at: https://www.blackrock.com/uk/individual/insights/investor-pulse; results based on survey of 4,000 UK nationals