Strategy

FCA Call for Input: Open Finance

Response from Nest Corporation

1 About us

Nest was established in 2010 as part of the auto enrolment programme to help people save for retirement. Unlike any other pension scheme in the UK, Nest has a legal obligation to accept any employer that wishes to use us to discharge their auto enrolment obligations. Over 830,000 employers have signed up to use Nest.

Over the last decade, Nest has grown to be one of the largest pension schemes in the UK. We are operating at scale as a high quality, low cost pension scheme helping over 9.3 million members save for their retirement. Many are low to moderate earners who may be saving into a pension for the first time. A typical Nest member earns around £20,300 per year and nearly half our members are aged under 35 years old.

Nest is built around the needs and behaviours of our members, from our approach to responsible investment to our focus on customer service. We now occupy a place in the market as a major Master Trust, helping to drive up standards and best practice across the industry. Nest has great potential for delivering pensions to mass market consumers for many years to come, leveraging our scale to deliver value through the combination of low costs, our market leading investment strategy and modernised services, all overseen by strong trustee governance.[1]

2 Response

Introductory comments

Nest agrees that there are benefits to consumers looking to engage and make active choices about their finances, aided by the opening up of banking and financial services. Nest serves millions of low to middle income members and is mindful of the need to protect and support those individuals for whom financial security, stability and good value are critically important. Thus, we also welcome the analysis contained in the OBIE Independent Consumer and SME Representatives' report from summer 2019, which suggests that open banking could be particularly beneficial for this type of consumer. Their modelling suggests that people could stand to gain £12bn from open banking-enabled services over the course of a year and that the 'overstretched segment' stand to gain most (£287, 2.5% of annual income).[2]

In addition to these financial benefits, we can see the potential for positive developments from open finance in terms which are wider and are perhaps less tangible, but nonetheless very valuable. These developments are more about underpinning behaviours and attitudes. They include supporting wellbeing (as anxiety about finances and financial choices may be mitigated to an extent by better

[1] Employer and member numbers correct as of 03/09/2020; Member earnings and age data correct as of 31/05/2020, quarterly briefing data pack, Scheme MI.

[2] https://www.openbanking.org.uk/wp-content/uploads/Consumer-Priorities-for-Open-Banking-report-June-2019.pdf

understanding and better decision-making tools); better understanding supporting the development of stronger underlying financial resilience; as well as a potentially longer-term shift in how people think and feel – normalising saving and financial planning, and building trust.

This Call for Input invites consideration of the impact and implications of progressing beyond open banking to open finance. As stated in the Call for Input, this would entail the extension of open banking-like data sharing and third-party access to a wider range of financial sectors and products, including pensions and investment. At Nest, whilst we can see some benefits as set out above, we also feel there are important considerations for consumer protection in this area - focused in particular around the assumption that access to information will always improve consumer outcomes. As such, we focus this response on the issues raised in Chapter Four on risks around poor consumer outcomes and competition. We have structured our response around the question we feel is most pertinent to our members (Q8 - see below).

Q8. Do you consider that the current regulatory framework would be adequate to capture these risks?

No. The current structures and frameworks do not adequately address potential risks to consumers arising from the development of open finance. In responding to this question, we highlight:

- Very low understanding of and engagement with pensions, or choices relating to them amongst mass market savers;
- The importance of work to define and agree a measure of value for money in pensions - and the fact that we are keen to be involved in this thinking;
- The importance of information relating to value for money being included on the dashboard and of research into consumer choices made in response to the single public dashboard taking place before multiple dashboards are enabled;
- The need to consider building friction into DC-DC transfer journeys.

Low engagement in pensions

Many of the benefits associated with the idea of expanding open finance rely on the assumption that more information leads to better decision making. Academic research has shown that interventions aimed at improving financial literacy can have a negligible effect on behaviour.[3] In addition, we know that in pensions, as with other more complex financial products, giving consumers more information can give them a false sense of security and lead to bad decision making.[4]

Nest supports efforts to find new ways to engage members, particularly by drawing on advances in technology, but it is critical within this that we do not increase risk to consumers who are starting from a very low level of knowledge.

Research with Nest members demonstrates some very basic misconceptions about pensions: many do not realise their funds are invested, and when they do, may react by saying they want to take their funds out of the scheme[5]; when thinking about retirement, members expect Nest to 'pay them a pension', not realising the complex choices they will have to engage with in order to turn their pension pot into a sustainable income.[6] And perhaps unsurprisingly, there is very low take up of the choices on offer to our members. Over 80% in our member survey are unaware that we offer a range of different investment funds and only 2% of members have switched from the default to another fund. This is not in itself a source of concern: the default is designed to meet the needs of the majority of our membership, and we know that active choice in this space risks leading to detriment. But it helps to

[3] Fernandes, Lynch, Netemeyer, (2014). Available online at: **http://pubsonline.informs.org/doi/abs/10.1287/mnsc.2013.1849**

[4] Lacko and Pappalardo, (2004). Available online at: **https://www.ftc.gov/reports/effect-mortgage-broker-compensation-disclosures-consumers-competition-controlled-experiment**

[5] 'Improving consumer confidence in retirement saving', Nest member research, 2014)

[6] 'Flexible, Lifelong Retirement Income: The Consumer Perspective' (Nest member research, 2016)

illustrate the relative passivity of our membership in comparison to the consumers of other types of financial product.

Data from recent surveys of our membership asking about the experience of transferring in and out of Nest suggest that emotional triggers such as convenience and simplicity are stronger motivations to undertake transfer activity than in-depth understanding and evaluation of costs and charges. Among those transferring into Nest, 57% agreed that the main reason for them doing so was that they wanted to put all their pensions in one pot; only 2% said that the main reason was because Nest offered a better a return on investment and for just 1%, it was because of Nest's better costs and charges. The picture is very similar among those transferring out of Nest. These findings are highly pertinent to considerations around expanding open finance. As it stands, there is a very real risk that people are consolidating their pots for convenience into vehicles with higher charges and lower average returns.

Challenges around the nature of what and how pension information is presented

Compared to current accounts and other parts of retail banking, pension products (particularly decumulation products) are considerably more complex and often involve considering a number of different probably unfamiliar features and thinking across different time frames, including the hard-to-envisage far out future. Consumers will have to consider a range of uncertain factors: whether and how long they will continue to work; their potential health needs and costs of long-term care; their expected longevity and more.

As consumers struggle to engage with this complexity, they will inevitably be reliant on how information is presented by providers, which leads to a potential for bias in that data could be presented in a way more favourable to that provider. In addition, there is a risk of a tendency to focus on easy 'metrics', i.e. those which are easy to compare, but give a one-dimensional and very limited perspective on the options under consideration. This could distract or distort views of what is important. This is particularly pertinent given the long-term nature of pension saving. Regularly checking balances, for example, can lead to poor decisions if people see the value of their accounts fluctuate with the market.

Pension information must be presented in such a way that is most likely to drive good outcomes. Any presentation that is intended to support decision making about consolidation and/or comparing across pensions should, we believe, include costs and charges information expressed as pounds and pence impact on savings, as well as – ideally - a broad measure of value for money. This is because people find pension charges hard to understand; and because on their own, they are probably not the best measure of value as they do not take into account, in particular, investment strategy and quality of governance. Nest welcomes FCA and TPR's joint commitment to considering how to measure and present value for money in pensions and is keen to be closely involved in this thinking. We believe that such a measure could go some way towards diminishing consumer risk related to dashboard(s) aimed at mass market members, who may use a dashboard with the express intent of considering where to consolidate their savings.

Different types of risks associated with different use cases

The pension use cases outlined in the Call for Input document appendix involve a range of different situations. We can see that some consumers may benefit from being able to see their pension pots alongside non-pension savings or assets in one place, if it leads them to make better decisions based on information they can understand and calibrate correctly.

However, the use cases also include situations which involve making comparisons across pension products, which, as discussed above, are more complicated. Consumers need to properly understand their options and make considered decisions. It is not clear this would necessarily happen in situations where ease and convenience may be top of mind for the consumer. In the absence of engaged and knowledgeable consumers, strong governance and protection is needed.

We also believe that in certain circumstances, there is a need for appropriate friction to be built into consumer journeys in order to slow down decision making and encourage consumers to consider their options in more detail. We already know that only a small proportion of consumers will take advice when making pension decisions and the robo-advice market remains limited. Furthermore, the FCA's own research into consumer attitudes suggests those who might benefit most from robo-advice may be least likely to trust it.[7] As it stands, it is possible for a consumer to consolidate their DC pensions into a single vehicle in a couple of clicks on a mobile phone. That decision may have very substantial ramifications for the retirement outcome of that individual. As we have raised directly with the FCA, we are concerned about consumer detriment arising from this type of DC to DC transfer, in particular individuals transferring to schemes that may represent poor value for money in relation to their source scheme(s) without any understanding of price difference and impact on savings.

Turning to the dashboard: it will be important to build in time to understand how consumers respond and engage with the information and opportunities presented by the dashboard before enabling multiple dashboards to be developed beyond the single public version. This will take time, so we would propose a significant period of evaluation and assessment – at least a year - before the development of multiple dashboards by the market is permitted. This will give the opportunity to better understand how consumers respond to access to greater information in a controlled setting and whether certain forms of presentation of information generate better or worse behavioural responses and outcomes. The insights gained can feed into guidance or regulation for any ‘open market’ versions and, beyond this, subsequent developments and innovations which bring in greater transactional functionality to the dashboard and are closer to the vision for ‘open finance’.

Closing comments

Open finance has important potential, but it also brings heightened consumer risk. Thanks to years of research into consumer understanding and behaviours in relation to financial products, it should be eminently possible to seek to manage these risks while at the same time encouraging the market to innovate in the interests of consumers. The right regulatory framework will be critical and require the support of relevant organisations. We look forward to working together with the FCA and tPR on these issues as the market continues to develop.

[7] https://www.fca.org.uk/insight/robo-advice-%E2%80%93-will-consumers-get-programme