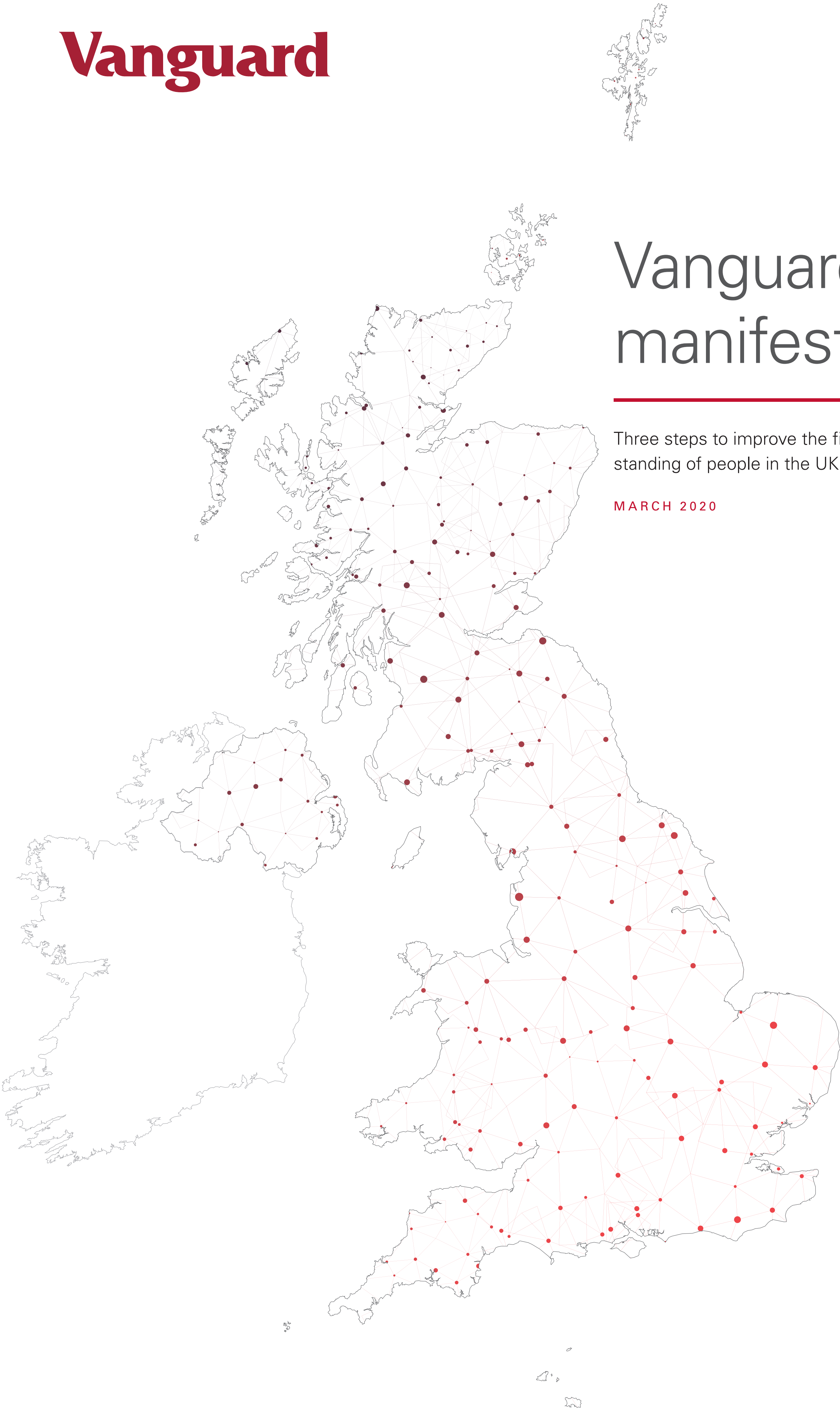
Vanguard's UK manifesto

Three steps to improve the financial standing of people in the UK

MARCH 2020



Sean Hagerty
Managing Director,
Vanguard Europe

Across the UK, millions of people are facing financial uncertainty. Pensioners don't know how to pay for a comfortable retirement and people are not always able to get the financial help they need at the right time and at the right cost. MPs hear these worries from their constituents every day. And sometimes they can seem almost too big to address. But, we think there are some simple things we can do today that will help people in the UK to see some light at the end of the tunnel.

I'm delighted to present Vanguard's manifesto of policy solutions which, we believe, will help improve the financial standing of people in the UK. Vanguard is a different kind of investment company. One that prides itself in taking a stand for all investors, treating them fairly, and giving them the best chance of investment success. For more than 40 years we have helped millions of people around the globe reach their financial goals, through access to low-cost, high-quality investment products and services.

In this manifesto we advocate that more must be done to encourage people to save. We must empower people by providing access to a range of advice and guidance options. And once people are saving, it is important that they have access to a fair deal.

We don't have all the answers, but we do have ideas. This manifesto is intended to provide a foundation for discussion and debate.

We want to help people build a better financial future by making it easier and cheaper to start saving. Because we think that putting money aside for the future should be something that everyone can do, on whatever scale they can afford.

I hope you find our manifesto insightful and thought-provoking. We look forward to discussing our policy proposals with you.

Sean Hagerty

Contents

Executive summary

Three steps to improve the financial standing of people in the UK

There is wide recognition that many UK households face a serious challenge in building an adequate retirement income. The figures are startling. According to a 2015 study by Deloitte, the aggregate household 'savings gap' in the UK could hit £350 billion by 2050[1].

To put this into perspective, based on the average UK earnings of £27,300, individuals will need approximately £18,200 in pension income per year (two thirds of their current earnings) to maintain their standard of living[2]. Even putting aside 8% of their salary per year through pension auto-enrolment and including the current state pension, individuals will face an annual retirement income shortfall of up to £5,500[3].

This is a significant but not insurmountable challenge. We believe that by taking three basic steps now, policymakers in the UK can begin to improve the long-term financial health of people in the UK.

1. Encourage people to save

Build on the strong foundations of recent reforms

A number of very positive steps have already been taken to encourage people to save more, including the introduction of financial education in UK schools and pension auto-enrolment. There is an opportunity to build on the strong foundations of these reforms by strengthening the incentive to save and simplifying the investment landscape for consumers.

Strengthening the incentive to save

We strongly support encouraging long-term saving through tax incentives for people saving into their pension. But the current pension lifetime allowance (the maximum value of pension benefits that can be built up before a significant tax levy is applied) is unnecessarily complicated, penalises successful long-term investment and discourages saving. We are asking that the pension lifetime allowance be removed. We also believe there is an opportunity to make pension tax relief fairer by introducing a flat rate of tax relief.

Simplifying the saving landscape for investors

Although choice is good, research shows that excessive choice can hinder people's decision to invest[4]. Individual savings accounts (ISAs) are an example of what used to be a relatively simple, tax-efficient UK savings vehicle that were widely understood by the general public. But the ISA landscape has become unnecessarily complex over recent years, due to the wide variety of different ISA products introduced by successive governments. We believe that the ISA regime could be simplified by limiting the number of different ISA products available. The introduction of 'kitemarked'[5] investment products that are low-cost, broadly diversified and easy to understand will also help the UK public in deciding where to invest their long-term savings, even if they have not received advice from a qualified financial adviser.

2. Ensure people have access to help

Promote the value of advice and guidance

Many investors need help from time to time to make successful investment decisions. Good advice can help people gain somewhere in the region of an additional 3% return per year[6].

1 Deloitte (2015), UK savings gap to reach £350 billion by 2050

2 Office for National Statistics (2017), Household disposable income and inequality in the UK: financial year ending 2017

3 Vanguard (2019), assumes: pension contributions from age 21 to 68 with opt-out periods and annual changes in earnings; total pension contribution of 8% of salary increased with inflation at a rate of 2.5%; 0.35% in total charges; and an annual investment growth rate of 5%. The estimated pension income is based on withdrawing 4% of the remaining pension pot each year.

4 Iyengar, I., Jiang, W., and Huberman, G. (2003), How much choice is too much?: Contributions to 401(k) Retirement Plans

5 Cambridge Dictionary (2019): a mark on goods that have been officially said to be of high quality.

6 Vanguard (2016), Putting a value on your value: Quantifying Vanguard Advisor's Alpha®

We are asking that the government, industry and regulators continue to take steps to stimulate the development of a market that delivers affordable and accessible financial advice and guidance for all. There is an important role for the newly-formed Money and Pensions Service to work closely with financial services firms to collectively provide consumers with the financial advice and guidance they need.

Encourage the development of a range of innovative advice and guidance options

Further development of a range of investment guidance and advisory solutions by firms is necessary to better allow UK consumers to receive the advice they require at a price they are prepared to pay. We would like to see the FCA further encourage innovative advice and guidance options by making use of the full flexibility that the UK regulatory regime permits. We believe that the FCA can catalyse technology-enabled advice offerings in the UK by better flexing the information that an adviser is required to obtain to determine whether the specific advice is suitable for the client or not, according to the type of advice that is being offered.

3. Ensure people have access to a fair deal

Help investors make better informed investment decisions

Lower investment costs enable investors to keep more of their returns. To improve consumer outcomes, it is essential that the UK public are put in a position where they can find the best investment deal.

Mandatory cost warnings within all investment documents will help consumers be more aware of the impact of costs on their net return.

Standardised pre-purchase review screens should be mandatory for consumers buying an investment product. This will allow them to compare the cost of their chosen investment products against peer-group offerings.

Ensure investors are able to transfer their investments to their preferred provider

Switching between investment providers remains too complex and time consuming. We believe that transfer times should be shorter and we support a mandatory time limit for organisations to complete each of their steps during the transfer process. We also want a ban on exit fees imposed on consumers leaving an investment platform. These fees penalise consumers and only serve to deter them from switching investment provider.

Proposed policy solutions

We hope our three-step framework will focus policy discussions and provide a foundation for continued discussion and debate. In order to close the UK's savings gap it is essential that we encourage the UK public to save for their long-term financial future, ensure they have access to the help they need and, once they are investing, make sure they are receiving a fair deal.

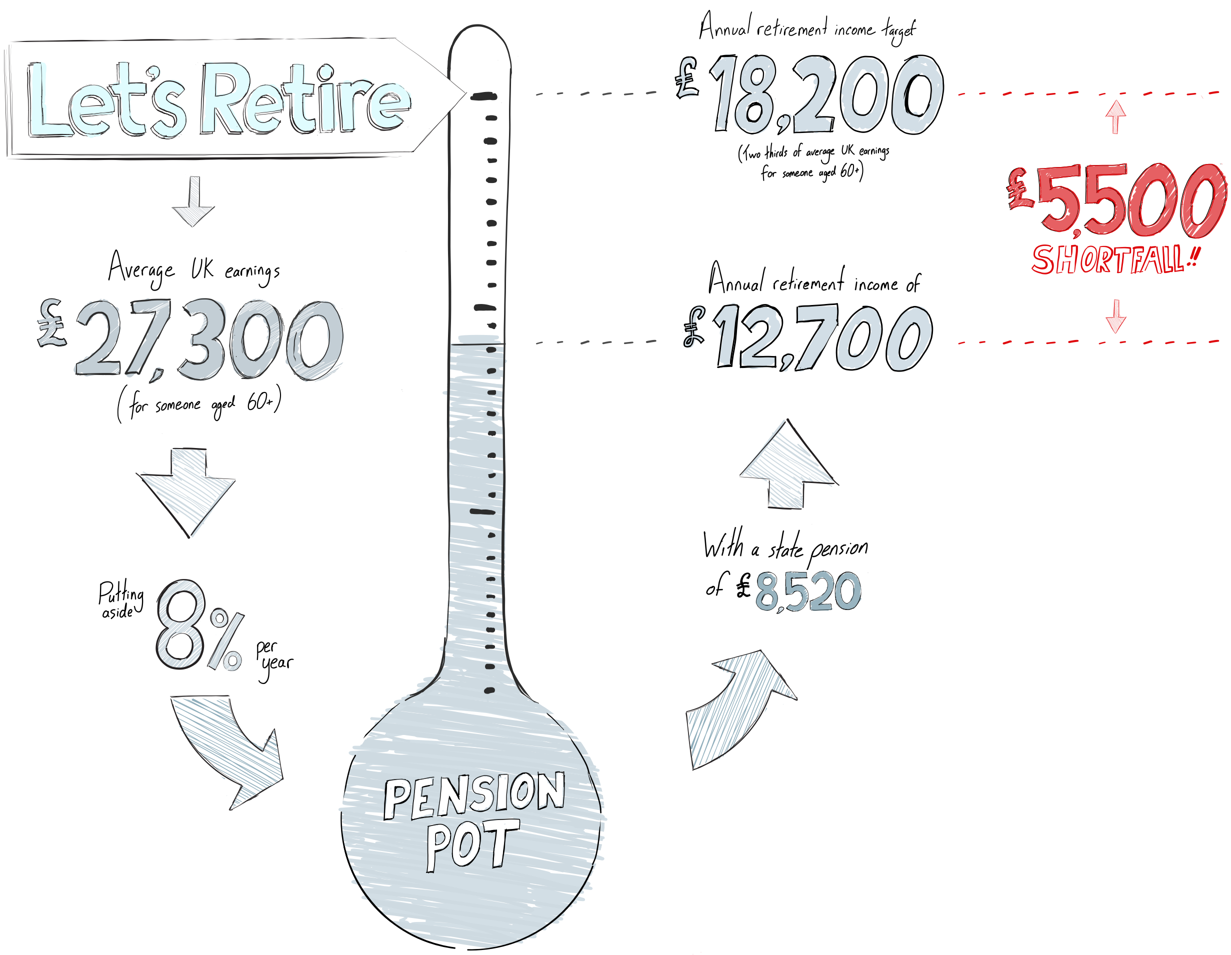
1. Encourage people to save	2. Ensure people have access to help	3. Ensure people have access to a fair deal
• Simplify the individual savings account (ISA) regime • Remove the pension lifetime allowance and introduce a flat-rate pension tax relief • Introduce kitemarked investment products	• Promote the value of advice and guidance through the Money and Pensions Service • Encourage the development of a range of advice and guidance options by better linking the 'suitability' information to be collected by advisers to the type of advice they are providing	• Introduce a mandatory cost warning in all investment documents for consumers • Require pre-purchase investment cost review screens • Introduce a mandatory transfer time between investment accounts • Ban platform exit fees

The UK's savings gap

People across Britain are facing considerable financial challenges, making it incredibly difficult for many to save enough to achieve their long-term financial goals, including living comfortably during their retirement. According to a 2015 study by Deloitte, the aggregate household savings gap in the UK could hit £350 billion by 2050[7].

To put this into perspective, based on the average UK earnings of £27,300 for employees aged 60 years and over, individuals will need approximately £18,200 in pension income per year (two thirds of their current earnings)[8]. Putting aside 8% of their salary per year through pension auto-enrolment, individuals may accumulate an estimated pension pot of £140,000. Including the current state pension, this yields an annual retirement income of £12,700 per year, a shortfall of up to £5,500[9].

Figure 1. Approximate annual pension income shortfall based on average UK annual earnings



Source: Vanguard.

7 Deloitte (2015), UK savings gap to reach £350 billion by 2050

8 Office for National Statistics (2017), Annual Survey of Hours and Earnings.

9 Vanguard (2019), assumes: pension contributions from age 21 to 68 with opt-out periods and annual changes in earnings; total pension contribution of 8% of salary increased with inflation at a rate of 2.5%; 0.35% in total charges; and an annual investment growth rate of 5%. The estimated pension income is based on withdrawing from the remaining pension pot at 4% per year.

There are many well-publicised reasons why people in the UK are not saving enough for their long-term future. They include broad economic and societal issues, such as weak wage growth, rising living costs, debt levels, short-term political and economic uncertainties and longer life expectancy. But, the UK public appears to also have specific preconceptions about investing that can prevent them from saving. For example, the belief that one needs a lot of money to start saving, and a fundamental lack of trust in financial institutions. Many also continue to see retirement as a distant issue, resulting in a preference for immediate consumer gratification over long-term delayed financial well-being.

"It's quite scary to think that you're not going to have enough to survive, for the basics when you get older"[10]

Three steps to tackle the UK's savings gap

Despite the seriousness of the challenges faced in the UK, we believe that by taking three basic steps policymakers in the UK could significantly help bridge this savings gap and improve the long-term financial health of the UK public:

Figure 2. The three-step solution

1. Encourage people to save

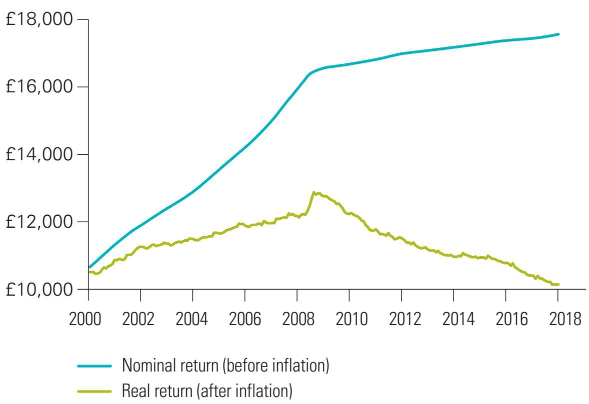
Why this is important

Enables the UK public to reach their future goals

Saving is ultimately a means to an end. It enables us to reach our future goals, such as getting married, buying a house, or living comfortably during retirement.

Short-term needs are often best met through savings accounts with banks and building societies. However, cash savings are typically less effective in the long term as a result of the erosive effect of inflation. Money put aside today is worth less in the future.

Figure 3. Returns from cash, before and after the effects of inflation.



Cash returns illustrated by ICE LIBOR GBP 3-month; inflation by the UK Retail Price Index.

Source: FactSet as at 30 November 2018. Past performance is not a reliable indicator of future returns.

For longer-term goals, where there is a need for a positive real return (after deducting the impact of inflation), savers typically need to accept some market risk from investing in company shares (equities) and company or government debt (bonds). This is in return for a higher potential long-term return. Over the long term, UK equities and UK government bonds have returned after-inflation annual returns of 5.0% and 1.3% respectively[11].

10 Vanguard & Opinium (2018), interviews conducted with savers in the United Kingdom to understand attitudes to saving and investing.

11 Barclays (2016), Equity Gilt Study 2016, (data from 1900 – 2016).

Compounded earnings (i.e. earning investment returns on past investment returns as well as on the original investment) can significantly increase the value of an investment over the long term. Delaying starting to save can have a significant negative impact on the extent of an individual's pension pot, as highlighted in the example below.

Consider two pension savers, Hannah and Michael. Hannah starts her pension at the age of 20, investing just £50 a month. Michael waits until he is 40, but invests £100 a month. Supposing an average investment return of 4%, when Michael is 60 he will have a pension pot of just over £36,500. Hannah, however, at the same age will have a pension pot of nearly £60,000. The two savers have invested exactly the same amount of money over time, but because of starting earlier and compounding, Hannah has ended up with nearly twice as large a pension.

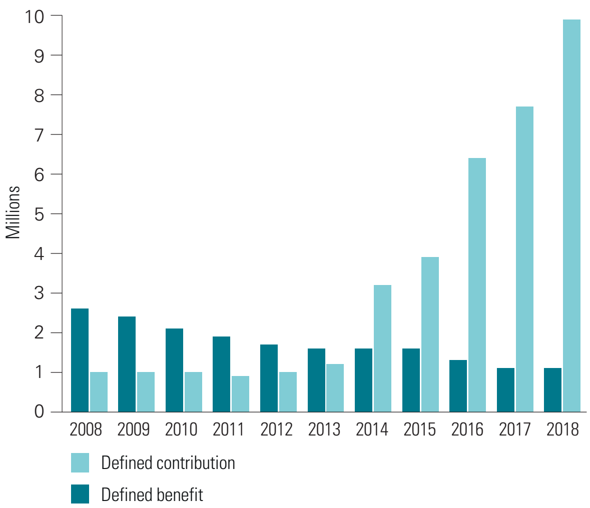
Source: Unbiased.

Note: the above investment pots do not take into account fees and costs.

People are now required to take on more responsibility for their retirement

People in the UK are now expected to take much more responsibility for their retirement than was previously the case. In part, this is due to the very significant shift from defined benefit (DB) pension schemes to defined contribution (DC) pension schemes, as shown in **Figure 4**.

Figure 4. Active membership of private sector occupational pension schemes by benefit structure



Source: Office for National Statistics (2018), Occupational Pension Schemes Survey: UK

Defined benefit (DB) pension: An employer-sponsored pension scheme where retirement income is based on length of employment and the individual's earnings. The employer guarantees a specified pension payment on retirement, securing an income for life.

Defined contribution (DC) pension: A pension scheme which invests the contributions made by the individual and/or the employer. Unlike DB schemes, which promise a specific income, retirement income from a DC scheme depends on how much has been paid in, the length of time that it has been invested and how the investments have performed over this period.

A DC plan places the financial risk of how a pension portfolio performs on the employee. If the investment return is weak or the employee lives longer than planned, the employee risks not having enough income for their retirement. In contrast, the risk of poor investment performance over the lifetime of a DB pension is borne by the employer, with employers having to make up any shortfall in performance against what they have promised to pay out.

What can be done?

Build on the strong foundations of recent reforms

A number of very positive steps have already been taken to encourage people to save more, including the introduction of financial education in UK schools, pension auto-enrolment and the Help to Save scheme.

Increased financial education, for both children and adults, will help ensure that the UK public is better equipped to make well-informed choices in a complex and changing financial landscape. It is important that the government, regulators and financial services industry continue to collaborate to encourage enhanced understanding and positive attitudes towards finance, budgeting and saving from an early age.

Well-placed 'nudges' encourage or even compel people to make decisions that are in their broad self-interest. One example of this is automatic enrolment, whereby employers enrol employees automatically into a workplace pension scheme. Auto-enrolment has particularly helped in increasing coverage of pension saving by younger, low-to-moderate income workers. Recent research by Vanguard and the National Employment Savings Trust (Nest) Insight research unit found that of Nest's membership of just over eight million members, nearly half are below the age of 35 and more than half have annual earnings of less than £20,000[12].

There is now an opportunity to build on the strong foundations of these reforms by strengthening the incentive to save and simplifying the saving landscape for investors. Saving for retirement is complex, in part due to continual changes to the retirement regime in the UK. There are multiple types of pension, annual and lifetime allowances, as well as differing tax reliefs dependent on earnings. Pension schemes also have their own rules and charges. Understandably this has led to the accusation that people are not engaging with their pension and not saving enough for the retirement they want due to the complexity of retirement saving.

Financial incentives can have a large impact on the form in which savings are held[13]. In the UK, the majority of household wealth is held in private pensions and in owner-occupied housing, as well as tax-favoured accounts such as ISAs. The tax treatment of these different vehicles and underlying assets varies widely and this can affect the attractiveness of saving in different forms for people in different circumstances. We also know that individuals are more likely to respond to simple incentives[14]. It is essential that the incentive to save is strengthened to ensure people in the UK can meet their long-term aspirations.

At the same time, it is important that any incentivisation is transparent and understood, so that complexity or lack of understanding does not undermine the propensity to save.

Strengthen the incentive to save

In order to incentivise long-term saving, the UK government currently provides tax incentives for both individuals and employers to save into pensions. As a result of pension tax relief, the contributions to a pension during an individual's working life can be tax-free. Tax is only paid when the pension is taken, encouraging individuals to defer their income until retirement.

In 2006, lifetime and annual pension allowances were introduced to limit the amount of tax-privileged pension saving that individuals could make. The lifetime allowance (LTA) is currently £1.055 million and the annual allowance is £40,000.

Lifetime allowance: A limit on the total value of a pension pot. Any pension benefits taken at retirement in excess of the lifetime allowance are subject to a tax charge (55% of any lump sum and 25% of any income).

Annual allowance: A limit on the amount that can be contributed to a pension each year. Any contributions exceeding the limit will not be eligible for tax relief and an annual allowance charge is payable.

Many believe the LTA only impacts the wealthiest in society. But research shows that breaching the LTA is a very real possibility for substantial parts of the population. When introduced in 2006, the lifetime allowance of £1.5 million meant that people could have a DC pension of around £70,400 per year without triggering an additional LTA tax charge. Due to reductions in interest rates and the LTA since 2006, this has reduced to, at best, around £26,000 per year[15].

The total pension pot for a DC pension is made up of contributions from the employee and employer (if applicable), plus investment returns and tax relief. As the LTA is assessed on the size of pension pot at retirement (not just the value of contributions), the LTA penalises successful investment performance. This discourages people from saving into a pension for fear of positive investment returns breaching the LTA.

What's more, the LTA rules differ depending on which 'type' of scheme a member belongs to. DB savers can secure an annual pension of

12 Vanguard & Nest Insight (October 2019), How the UK Saves 2019. Nest was set up by the government especially for auto-enrolment, to ensure that every employer has access to a workplace pension scheme.

13 Institute for Fiscal Studies (IFS) (2016), The effects of taxes and charges on savings incentives in the UK

14 Institute for Fiscal Studies (IFS) (2012), Do up-front tax incentives affect private pension saving in the United Kingdom?

15 According to figures from Retirement Advantage, a specialist retirement financial adviser.

around £50,000 without breaching the LTA. But, as mentioned above, DC savers can only secure an annual pension of around half of that. This is particularly challenging in light of the increasing move to DC pension provision in the UK.

A pension tax system that delivers a consistent and fairer outcome for all individuals could improve the UK public's willingness to engage with pension saving[16]. Instead of the current situation where individuals receive tax relief on any pension contributions they make at the highest rate of income tax that they pay, a universal 30% flat rate of pension-contribution tax relief would be more progressive in directing relief to those who would benefit most (**Figure 5**). As well as being cost-neutral, it would leave three-quarters of earners better off[17].

Figure 5. Distributional impact of tax-relief reform[18]

Income tax rate	Share of taxpayers claiming tax relief	Share of net pension contributions (current)	Share of pension tax relief (current)	Share of reformed tax relief (30% flat rate, fixed net contributions)
Basic (20%)	75%	51%	32%	51%
Higher (40%)	23%	41%	53%	41%
Additional (45%)	2%	8%	15%	8%

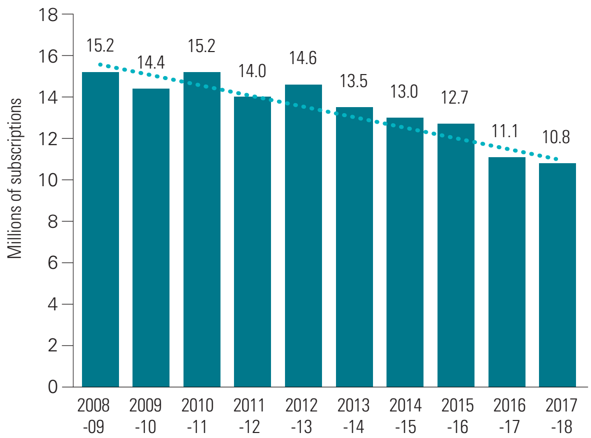
In addition, while there is evidence that cash bonuses and direct matching can stimulate saving, tax relief is poorly understood by the UK public[19]. To further improve pension contributions, we believe that tax relief should be reframed as a government 'bonus' in return for saving towards retirement. This should serve to strengthen the public's perception and understanding of tax relief as a positive incentive.

Simplify the saving landscape for investors

Individual savings accounts (ISAs) are an example of what used to be a relatively simple, tax-efficient UK savings vehicle that was generally understood by the public. Historically, ISAs have been attractive in encouraging people to save, whether in cash or investments, or both. However, the ISA landscape has become unnecessarily complex over recent years, with a wide variety of different and overlapping products available (see **Appendix 2**).

As a result, despite recent annual increases in ISA limits, the number of ISA accounts subscribed to each year has decreased (as shown in **Figure 6**)[20] although low interest rates and market uncertainty have also likely played a part.

Figure 6. Number of adult ISA accounts subscribed to per year (in millions) [21]



Source: HMRC.

16 HM Treasury (March 2016), Strengthening the incentive to save: summary of responses to the consultation on pensions tax relief

17 Royal Society of Arts (April 2018), Venturing to Retire

18 Royal Society of Arts (April 2018), Venturing to Retire

19 House of Commons Treasury Committee (July 2018), Household finances: income, saving and debt

20 The current ISA allowance is £20,000 per tax year, which can be held in cash, in an innovative finance ISA or in a stocks & shares ISA, or a combination of them all. Any unused allowance does not roll over to the following tax year.

21 HM Revenue & Customs (August 2018), Individual Savings Account (ISA) Statistics

Simplification and standardisation of the current ISA regime would make ISA features more widely understood and encourage consumers to save through them. We support the recommendations from the Tax Incentivised Savings Association (TISA) that the current cash, stocks & shares and innovative finance ISAs should be folded into a single ISA wrapper[22]. The Lifetime ISA would continue to exist, but would be enhanced to be more attractive to both consumers and providers. This would result in two types of ISA: a flexible ISA for general savings needs (including retirement) and a more restrictive Lifetime ISA specifically for housing or retirement needs. We believe that this twin-track approach would create a simpler and more understandable ISA landscape for consumers.

Although an extensive array of investment options can seem appealing to consumers, research has found that choice can hinder motivation to invest[23]. Consumers can in fact benefit from regimes that simplify matters by directing them to 'default' or kitemarked investments with, or without, financial advice. Tellingly, just over 98% of Nest members were invested in Nest's default investment scheme as at 31 March 2019[24].

"I was just flummoxed by the variations and what was different between the products... If it was government approved you assume that if they're putting their name to it they are more trustworthy, it would make me feel better"[25]

We believe that in this environment, there is a public appetite for consumers to be directed towards simple, low-cost investment products. Admittedly, previous initiatives by the government to signpost consumers to simple, low-cost products, for example, CAT (charges, access, terms) - standards and stakeholder pensions were not successful. There were, however, a number of reasons for this, including the fact that the prescribed cost caps limited the ability of product providers to pay the commissions necessary to have intermediaries distribute these products. We believe that the current regulatory environment should give similar types of initiatives more chance of success today. Notably, commission payments to advisers and platforms from product providers were banned under the FCA's Retail Distribution Review (RDR). This means that there is no longer the same intermediary bias against selling simple, low-cost investment products. In addition, as consumers have become aware of the cost of advice, many now choose to look for investment products online (without advice), sometimes seeking information and guidance from the likes of the Money and Pensions Service and Citizens Advice.

Government-approved investment products are a concept that exists, or is being considered, in other countries. For example, in Australia, a January 2019 report from the Productivity Commission recommended that the government introduce a 'Best in Show' shortlist of up to ten superannuation (pension) default products[26]. The Commission believes that these 'Best in Show' funds will help those saving for their pension who are simply looking for a good retirement outcome but don't want to make an active choice in respect of the approximate 40,000 eligible products that exist.

22 Tax Incentivised Savings Association (August 2018), Strengthening the ISA: TISA Proposals.

23 Iyengar, I., Jiang, W., and Huberman, G. (2003), How much choice is too much?: Contributions to 401(k) Retirement Plans

24 Vanguard & Nest insight (October 2019), How the UK Saves 2019.

25 Vanguard & Opinium (2018), interviews conducted with savers in the United Kingdom to understand attitudes to saving and investing.

26 Australian Government Productivity Commission (January 2019), Superannuation: Assessing Efficiency and Competitiveness

How policymakers can help

Remove the pension lifetime allowance and introduce a flat-rate tax relief
The pension lifetime allowance should be removed. In addition, pension contribution tax relief should be set at a flat rate for all UK taxpayers.

Simplify the ISA regime
There should be two types of ISA: 1) a flexible ISA for general savings needs, incorporating the flexibility offered by the current Cash, Stocks & Shares and Innovative Finance ISAs; and 2) a more restrictive Lifetime ISA specifically for housing and retirement needs – this would be an enhanced and simplified version of the current Lifetime ISA.

Introduce kitemarked investment products
Consumers would benefit from availability of 'kitemarked' investment products that are low-cost, broadly diversified and easy to understand. These products should be recognised as appropriate to be sold with, or without, advice.

2. Ensure people have access to help

Why this is important

Facilitates successful investment decisions

Many investors need help from time to time to make successful investment decisions. Vanguard research has quantified the value of a (good) advisory relationship as somewhere in the region of an investment return of 3% per year[27]. Behavioural coaching helps investors stay calm in turbulent markets and stick to their financial plan. However, currently people in the UK can struggle to find the right support, at the right time, at a price they are willing to pay. This has resulted in the existence of an 'advice gap' for at least some segments of the population. In 2017, only 6% of all UK adults obtained regulated financial advice, whereas it was estimated that a further 25% of UK adults had a need for advice but did not receive it[28].

3% per year

The value of good investment advice

What can be done?

Ensure the UK public has access to a range of different advice and guidance options

The government, industry and regulators must continue to take steps to stimulate the development of a market that delivers affordable and accessible financial advice and guidance to everyone, particularly those who do not have significant wealth or income.

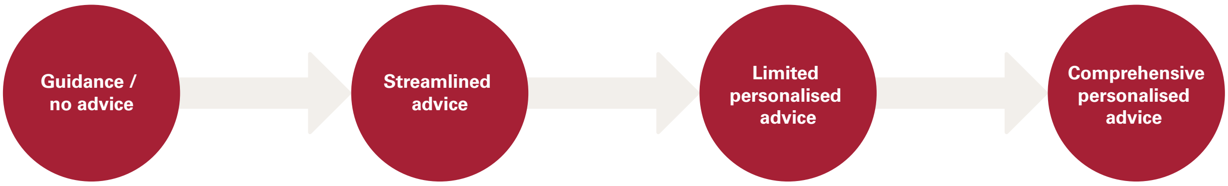
Advice: A personal recommendation to buy or sell a particular investment based on personal specific circumstances and financial objectives.

Guidance: More general information about financial products.

Further development of a range of investment guidance and advisory solutions would better allow UK consumers to receive the advice they require at a price they are prepared to pay. In recognition that not all investors need full-blown personal investment advice, these solutions should range from relatively simple and limited guidance which may be provided online, through to traditional face-to-face comprehensive financial advice as shown in Figure 7.

27 Vanguard (2016), Putting a value on your value: Quantifying Vanguard Advisor's Alpha®
28 HM Treasury and FCA (2017), Financial Advice Market Review Baseline Report

Figure 7. Advice and guidance options



> "It feels wrong to ask for financial advice…I don't feel I have enough money to have the right to ask for that"[29]

We fully support the increased focus from the UK government and the FCA on the regulatory framework governing the provision of financial advice and guidance under the Financial Advice Market Review (FAMR) and the Retail Distribution Review (RDR). Noteworthy examples include: the development of a 'streamlined advice' regime[30]; the FCA's regulatory sandbox allowing firms to test their innovative fintech solutions in a real market environment; and the FCA's advice unit to help firms develop automated advice models.

To enable the development of a wider range of investment guidance and advisory solutions, it is imperative that the FCA applies its rules proportionately. The 'relevant' or 'necessary' information that an adviser must collect to demonstrate that the advice given is suitable to the client's circumstances will depend on the extent of the advice provided. We believe that firms continue to be reluctant to launch advice offerings other than comprehensive personalised advice for fear of being deemed to have collected insufficient suitability information for the advice provided. For example, it is both logical and in clients' best interests that the information an adviser should collect is different for: 1) a client that is looking for comprehensive planning in respect of all areas of their financial wellbeing, versus 2) a client only seeking advice as to which investment fund he/she should purchase with a one-off payment.

Emerging financial technology is simplifying and lowering the cost of investing for everyday savers. It is also encouraging younger investors, who may have initially thought investing was too complex and expensive, to start saving to reach their long-term financial goals. In May 2017, Vanguard launched a digital investing service to UK retail investors. 46% of the investors using this service are below the age of 35[31]. This runs counter to the perceived wisdom that young people cannot, or will not, save.

Technology-enabled advisory solutions have an important role to play in providing affordable and accessible advice to investors who would otherwise be trapped in the advice gap. Automated advisory platforms ('robo-advisers') have the potential to be revolutionary for savers and investors, both in terms of enhancing accessibility and providing services at lower cost. For this reason Vanguard launched its Personal Advisor Service (PAS) in the US, which provides customised, comprehensive financial plans for investors. This 'hybrid' advisory service uses technology services in combination with the judgement and ongoing relationship of a human adviser. At a cost of 0.30% for investors with US $50,000 (around £40,000) in investible assets, PAS represents a considerable cost saving over traditional advice offerings and is significantly below the minimum investible assets threshold of most traditional advisers.

29 Vanguard & Opinium (2018), interviews conducted with savers in the United Kingdom to understand attitudes to saving and investing.

30 Advisory services that provide a personal recommendation but that are limited to one or more of a client's specific needs (i.e. the service does not involve analysis of the client's circumstances that are not directly relevant to those needs).

31 Vanguard (2020), UK Personal Investor: 31 January 2020.

How policymakers can help

Promote the value of advice and guidance

Policymakers should help build an educational environment where the value of financial advice is understood and encouraged. The newly formed Money and Pensions Service should work closely with financial services firms to collectively provide consumers with the financial guidance they need.

Encourage the development of a range of advice and guidance options

Consumers should have access to a wide range of advice and guidance options (including low-cost, technology-enabled advice) to meet their needs. In order to encourage innovation, the required 'suitability' information collected by advisers should be proportionate to the type of advice provided to the client.

3. Ensure people have access to a fair deal

Why this is important

Costs matter

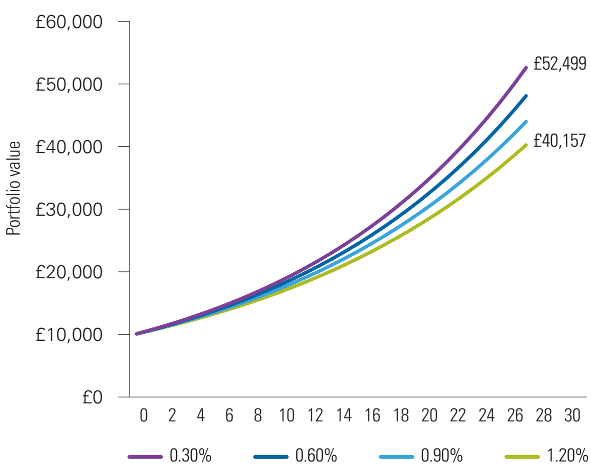
Low investment costs enable investors to keep more of their returns. An investor's return is decreased by every pound spent on investment-related costs. This is particularly important when people do not have substantial sums to invest or there is a low-return environment. Research consistently shows that lower-cost funds outperform their higher-cost competitors over the long term and the best way to predict the future relative performance of a fund is its cost[32]. However, awareness of costs amongst UK savers is very low. Nearly a third of all consumers saving through an investment platform or fund supermarket do not know whether they pay platform charges for investing, or do not think that they pay any at all[33].

"I don't think I'm being charged for anything that I'm investing in, but I may be"[34]

There is generally little consumer engagement with investment product fees, with past performance driving decision making[35]. But, past performance is often not reflective of future performance. It is also easy to mistakenly apply experience from other areas of life to the fund industry: when you are buying a house, a car or a TV, if you pay more you are (arguably) likely to get a better product. But in investing, the data tells us that the opposite is true. In investing, lower fees mean you keep more of your returns.

The graph below (**Figure 8**) shows the effect costs can have on long-term portfolio growth. It depicts the impact of expenses over a 30-year period on a hypothetical portfolio, with a starting value of £10,000. In this case, the investor paying the higher charges ends up with over £12,000 less in savings.

Figure 8. Impact of costs and charges on investment net returns. Assuming a starting balance of £10,000 and a yearly return of 6%, which is reinvested



Source: Vanguard.

Note: This hypothetical example assumes an investment of £10,000 over 30 years and does not reflect any particular investment. Annual compounding is used for both the assumption of 6% average growth per annum and the investment costs. Costs are applied to average annual growth of 6% for each year.

32 Morningstar (2016), How Fund Fees are the Best Predictor of Returns

33 FCA (July 2018), Investment platforms market study interim report

34 Vanguard & Opinium (2018), interviews conducted with savers in the United Kingdom to understand attitudes to saving and investing.

35 Vanguard & Opinium (2016), Qualitative study with 20 retail investors, quantitative study with 2,000 investors.

What can be done?

Help investors make better informed investment decisions

We need to help investors become smarter investors. Clear, concise, engaging and helpful communications are needed to help consumers make better-informed investment decisions. Our research has found that there is an appetite for standardisation and more simplified reporting, particularly on fees. However, simple information should also be available in order to help people understand and compare other aspects of investing, including performance and risk. Currently, consumers find investment statements less easy to understand than statements received in respect of current accounts, credit cards and utilities[36]. Providing consumers with information that encourages competition will improve services and lower costs, improving investor returns.

The FCA's findings in its Occasional Paper 32 *"Now you see: drawing attention to charges in the asset management industry"*[37] (OP32) confirmed that when consumers are made aware of the impact of costs on their net return and are able to compare costs against peer-group offerings, this significantly improves (by over 10%) the proportion of participants selecting a cheaper fund. However, this positive impact will only be felt if the entire investment industry is playing by the same rules. For example, voluntary adoption by a firm of a cost warning on the impact of costs on net returns actually risks this firm's products being viewed by consumers as 'high-cost' in comparison to organisations that do not include such a warning. This will be the case regardless of whether the products of the provider including such a warning are actually high-cost or not. Furthermore, effective comparison between the costs of investment products will only be possible where there is standardisation of underlying data and the way costs are calculated.

Ensure investors are able to transfer their investments to their preferred provider

Once investors are in a position to find the best deal, they should then be able to transfer their investments to their selected provider quickly and easily at minimum cost.

Unfortunately, the switching process for UK investors is complex, time consuming and lacks transparency. Our research has found that respondents are less likely to take the step of switching their investment provider than they are switching their provider for home insurance, gas or electricity, or broadband provider[38].

"Trying to move everything around is quite an effort. So, I think sometimes it is just easier to leave it"[39]

Consumers who are motivated to transfer their investments to a platform which better meets their needs often experience transfer times well in excess of target timeframes[40]. Our internal data suggests a median duration of transfers of around 20 days, with nearly one-third of cases extending over 30 days. In some instances the transfer experience for consumers has been so unsatisfactory that they have cancelled re-registrations mid-transfer. This is supported by FCA research which found that 7% of consumers have tried to switch at some point but failed[41].

Our internal data suggests a median duration of transfers of around 20 days, with nearly one-third of cases extending over 30 days

36 Vanguard & Opinium (2016), Qualitative study with 20 retail investors, quantitative study with 2,000 investors.

37 FCA (2018), Now you see it: drawing attention to charges in the asset management industry

38 Vanguard (January 2018), research included 2,001 nationally representative UK adults (aged 18+) and 1,000 UK investors with 10k+ assets aged 50+.

39 Vanguard & Opinium (2018), interviews conducted with savers in the United Kingdom to understand attitudes to saving and investing.

40 See, for example, the TEX standards which provide for signatories to complete transfers and re-registrations of funds held within individual savings accounts and general investment accounts within eight business days. Note that adoption of the TEX standards is voluntary and not all platforms have signed up to comply with these best practices.

41 FCA (July 2018), Investment platforms market study interim report

Exit fees are one of the top three barriers to switching providers (in addition to time involved and complexity)[42]. Some providers of investment platform services charge customers £10 to £30 for each investment they move to another provider. In addition, some platform providers charge a flat exit fee to close the account. These fees serve as a deterrent to switching and can add up to a significant portion of the value of the account being transferred.

We are supportive of STAR, the industry framework endorsed by the Transfers and Re-registration Industry Group, which outlines a faster and more efficient process for the transfer of investments between providers[43]. TRIG has proposed that firms should complete each of their own steps for all transfer and re-registration processes within a specified timeframe. However, this is a voluntary framework and, for this to be effective, we believe that these timeframes should be mandatory across the industry.

How policymakers can help

Mandatory high cost warning & standardised review screen

Investment providers should be required by the FCA to be more explicit as regards to the impact of the costs they charge on investors' returns.

Investment providers should be mandated to include a specific warning in all consumer documentation about the negative effect on returns of paying high charges.

WARNING:
CHECK HOW MUCH YOU ARE PAYING.
HIGH FEES WILL HARM YOUR LONG-TERM RETURNS.

Investment providers should provide a pre-purchase summary of the costs and charges for an investor's chosen investment, as well as a chart comparing the investment's charges to others in the same category. Please see an example from the FCA's OP32 below:

Check how much you are paying before continuing ...

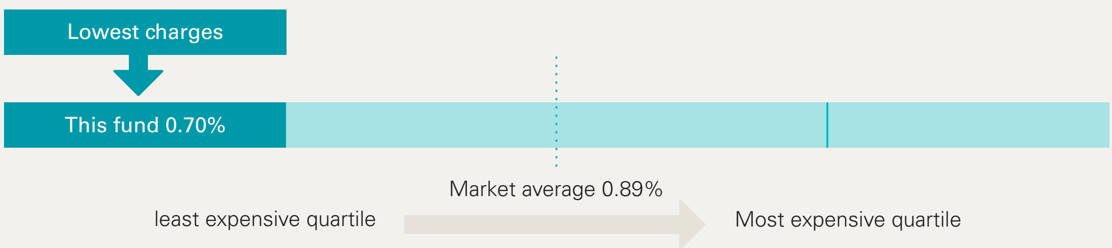
You have selected the following fund with the following charges

Example UK Fund

	Charge (%)	Charge (Per £10,000 invested)
Ongoing charge (OCF)	0.70%	£70
Transaction costs	0.18%	£18
Platform charge	0.30%	£30
Total costs and charges	1.17%	£117

Note: Transaction costs are the costs that are incurred when a fund manager buys and sells investments as part of managing the fund. The transaction costs above are estimated and the actual cost incurred may differ from this.

How does the ongoing charge (OCF) compare to other UK equity funds



I have checked and want to proceed

I want to select another fund

42 FCA (July 2018), Investment platforms market study interim report

43 Transfers and Re-registration Industry Group (June 2018), Industry-wide framework for improving transfers and re-registrations

Mandatory transfer time between investment accounts
There should be a mandatory timeframe for each step of an investment transfer to be completed.

Ban platform exit fees
The FCA should ban providers of investment platform services from charging exit fees when consumers transfer their investments to a new provider.

Conclusion

Research, position papers and reports from UK policymakers and regulators have already indicated a commitment to introduce measures to address the UK's 'savings gap'. We believe that our proposals can further help focus policy discussions on specific measures that can be taken to help the UK public reach their long-term financial goals.

We hope our three-step framework will provide a foundation for continued discussion and debate. In order to close the UK's 'savings gap' it is essential that we encourage the UK public to save for their long-term financial future, ensure they have access to the help they need and, once they are investing, make sure they are receiving a fair deal.

1. Encourage people to save	2. Ensure people have access to help	3. Ensure people have access to a fair deal
• Simplify the individual savings account (ISA) regime • Remove the pension lifetime allowance and introduce a flat-rate pension tax relief • Introduce kitemarked investment products	• Promote the value of advice and guidance through the Money and Pensions Service • Encourage the development of a range of advice and guidance options by better linking the 'suitability' information to be collected by advisers to the type of advice they are providing	• Introduce a mandatory cost warning in all investment documents for consumers • Require pre-purchase investment cost review screens • Introduce a mandatory transfer time between investment accounts • Ban platform exit fees

Appendix 1:

Background on Vanguard

Vanguard is one of the world's largest asset managers, offering a wide selection of investment funds to direct investors and like-minded intermediaries (including pension providers). Vanguard's global assets under management were just under £4.65 trillion as at 31 December 2019. Vanguard Asset Management Limited is based in London and as at 31 December 2019 managed just under £224 billion.

Vanguard aims to offer investors the highest value investment products and services available and has an unwavering focus on investor value and costs. The Vanguard Group, Inc. (VGI), is owned by the US-domiciled funds that VGI manages, and these funds are in turn owned by the investors in the funds. This unique structure aligns our interests with those of our investors – benefiting investors worldwide – and drives the organisation's culture, philosophy and policies.

Vanguard has a stated intention of being a price leader and is committed to cutting the cost of investing. Vanguard's scale also helps to keep costs low. As our assets under management increase, Vanguard can further reduce the cost of investing for the investors in our funds.

In May 2017, Vanguard launched a direct investment Personal Investor service (www.vanguardinvestor.co.uk) to UK retail investors. This online investment service is designed to help simplify and lower the cost of investing for individual investors from all financial backgrounds and needs. By accessing Vanguard's funds directly, investors benefit from one of the best value for money offerings in the UK and can avoid the additional fees often charged on other platforms. The service's annual account fee is 0.15% on balances up to £250,000 and free thereafter, effectively capping the fee at £375 each year. UK retail investors can invest with as little as £100 per month or a lump sum of £500. The service helps investors navigate an increasingly complex investment landscape by providing clear information and education with the aim of giving them the best chance for investment success.

In line with its mission of taking a stand for investors, Vanguard proactively engages in policy discussions to help ensure the UK market operates in a way that investors have the best chance of investment success[44]. Recent examples have included:

- Publication, in conjunction with the National Employment Savings Trust (Nest), of 'How the UK Saves' which examined the choices, demographics, behaviours and outcomes of the nearly 10 million members (equivalent to roughly one third of the UK workforce), and over 800,000 employers using Nest. We believe this is the largest longitudinal study of its kind outside of the census[45].

- The FCA's call for input on RDR and FAMR, where we continue to advocate merits of low-cost advice and the role of technology-enabled advice in reducing the advice gap.

- The Work and Pensions Committee inquiry on pension costs and transparency, where we highlighted ongoing issues around the transparency and disclosure of charges at and through retirement for pension savers and highlighted the positive impact of sound, good value advice from professional advisers[46].

44 Vanguard's stated mission is: "To take a stand for all investors, to treat them fairly, and to give them the best chance for investment success".

45 Vanguard & Nest insight (October 2019), How the UK Saves 2019.

46 Vanguard (September 2018), Response to Work and Pensions Committee inquiry into pensions costs and transparency.

Appendix 2:

Current individual savings accounts (ISAs), 2019 - 2020

The current ISA allowance is £20,000 per tax year, which can be held in cash, in an innovative finance ISA or in a stocks & shares ISA, or a combination of them all. Any unused allowance does not roll over to the following tax year.

ISA type	Description
Cash ISA	An account that pays interest on cash savings tax free, as opposed to ordinary savings accounts on which tax may be payable.
Stocks and shares ISA	An account whereby you can invest in equities (company shares) or bonds (company or government debt) without incurring tax on any income received or due to an increase in the value of the investments.
Innovative finance ISA	Allows savers to use some, or all, of their annual ISA investment allowance to receive tax-free income and tax-free capital gains on investments made through peer-to-peer lending platforms.
Junior ISA	An account (cash or stocks & shares) for children under the age of 18 where no tax is incurred on any interest or income received or due to an increase in the value of the investments. Parents or guardians with parental responsibility can open a Junior ISA for their child and money cannot be withdrawn until the child is 18. The savings limit is currently £4,368 per tax year.
Lifetime ISA	An account which enables those aged between 18 and 40 to pay in up to £4,000 each tax year, with contributions qualifying for a 25% government bonus towards their first home or retirement. Withdrawals in line with the conditions of the account (e.g. at age 60 for retirement) are tax free.