Department
for Work &
Pensions

Permitted Charges within Defined Contribution Pension Schemes

Government response to the May 2021 consultation on the implementation of a de minimis on charging of flat fees, including proposed regulations and on the reform of the permitted charging structures

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Ministerial foreword

A key ambition of this government is to drive better outcomes for members of Defined Contribution pension schemes and help ensure they achieve the best possible retirement. This can only be achieved by putting members' interests first.

I have previously set out my commitment to protect members who are automatically enrolled into a qualifying, defined contribution pension scheme, and especially those with smaller pension pots, from high and unfair charges and from the risk of erosion to their pension savings from such fees.

Equally, I want to drive up member awareness of their pensions, and enable them to make informed choices to ensure they are contributing to the pension product that suits them best.

In May 2021, I launched the consultation *Permitted Charges and Defined Contribution Pension Schemes*, to gather further views and additional evidence on the de minimis on the charging of flat fees, and on the draft Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2021, which will implement that protection to the savings of members with small pension pots. This consultation has also been an important opportunity to gather evidence and understanding of industry, member and wider views on proposals to reform the permitted charging structures in default arrangements.

This is the government's response to that consultation.

We will put in place regulations to implement a de minimis on the charging of flat fees as part of a combination charge from April 2022. This will ensure that a member's pension savings at or below £100 will be protected from flat fee charges.

The consultation, which ran from 24 May 2021 to 16 July 2021, has helped broaden our evidence base, and understanding of respondents' views regarding the proposal for a universal charging structure. I know this is of great interest to the automatic enrolment sector and I believe that clarity and comprehension around charges is important, but I will not rush into making decisions. My Department will respond separately on this issue and set out next steps shortly.

Guy Opperman MP
Minister for Pensions and Financial Inclusion

Chapter 1: Background and Summary

About this Government Response

1. This document forms the government's response to a consultation on the draft Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2021 ("the draft Regulations"), which ran from 24 May 2021 to 16 July 2021. It sets out:
   - a summary of the evidence received in response to this consultation
   - the government's response to chapters 3,4,5 and 7 of our consultation: "*Permitted Charges in Defined Contribution Pension Schemes*[1]".
   - our intended changes to the Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2021 (the "Amendment Regulations"), which are designed to introduce requirements to prevent flat fees being charged to members of certain occupational pension schemes with rights in the default arrangement of those schemes that would reduce the value to less than £100.

2. As pensions policy is reserved in Wales and Scotland, the Permitted Charges in DC pensions consultation, and this response, applies to England, Wales and Scotland.

Permitted Charges in Defined Contribution Pension Schemes consultation

3. On 24 May 2021, this Department published its consultation "*Permitted Charges in Defined Contribution Pension Schemes*", which set out proposals to protect small pots in default arrangements from erosion to zero. This would implement a level of £100 in the value of occupational pension scheme members' rights, below which the flat fee element of a combination charge cannot be charged. This consultation also presented the draft Regulations to implement this change.

4. This consultation also sought views on the proposal that the government should rationalise the current three permitted charging structures within the default fund arrangement, down to a single universal charging structure.

5. We received 32 responses to this consultation exercise – a full list of respondents is set out at **Annex A**.

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[1] Permitted charges within Defined Contribution pension schemes - GOV.UK (www.gov.uk)

Chapter 2: Policy on Flat Fees

Background

6. The June 2020 "*Review of the Default Fund Charge Cap and Standardised Cost Disclosure*[2]*"* included a call for evidence, which sought views on the need to protect scheme members in scope with small pension pots, particularly small deferred pension pots, which are subject to a flat fee as part of a combination charge, from the risk of their pots being eroded or even charged out to zero. That call for evidence found broad support to protect these small pension pots.

Summary of original proposals in the Permitted Charges in DC Pensions consultation document

- The de minimis will apply only to the flat fee element of the combination charge.
- The other element of this combination charge – a percent charge based on the member's value of funds under management, is unaffected by the de minimis, and may continue to be charged on any value pot.
- The de minimis will initially be set at £100. A pot of this value or below will not attract a flat fee charge.
- Where a member has multiple pots within the same provider's default arrangement which charges a flat fee charge, the assessment of whether a flat fee should be charged upon that member's rights, will be based on the combined value of those pots (the member's rights), rather than on the separate value of the individual pots. In such a scenario, a flat fee can only be levied once per member.
- Where a member has several small pots of £100 or less with different pensions providers, for which a flat fee is chargeable, then the de minimis will be applied according to the value of the member's pots (their rights), for each provider.

[2] Review of the Default Fund Charge Cap and Standardised Cost Disclosure - GOV.UK (www.gov.uk)

Stakeholder responses

Q1: Do you agree with our proposal that the de minimis should apply to all active and deferred pots? If not please outline why.

7. There was general consensus and support for the implementation of a de minimis to help limit the risk of erosion, and potential charging out to zero of small pension pots. 23 respondents agreed that the de minimis should apply to both active and deferred members. This approach would make the de minimis easier to administer and will minimise the complexities and additional costs that would be incurred when trying to distinguish between active and deferred pots.

8. A subset of these 23 respondents also highlighted that the definition of 'deferred' pension pots is not universal between providers so applying the de minimis to all pension pots below a certain threshold will make it easier to administer.

9. There were four responses who suggested that the de minimis level should be raised to a higher amount. They questioned whether the £100 threshold is the right level for the de minimis as it will have a negligible impact on member outcomes.

10. Two respondents told us that applying the de minimis is likely to create further cross-subsidies between larger pots and those below the de minimis, and that trustees and governance committees should be obliged to understand, manage and be accountable for any cross subsidies in their default scheme that arise.

11. One respondent raised a concern that the introduction of the £100 de minimis could lead to expectations that flat fees will not apply to any pension balance below £100, including amounts held in a self-invested personal pension on an investment platform, where such investments are simultaneously offered by a provider.

12. Whilst supporting the proposal to apply the policy to both active and deferred members, another respondent commented that, given the nature of a DC arrangement, some small pension pots could fluctuate between being in or out of scope of the de minimis. To enable provider administrative processes to operate as effectively as possible, it was suggested that the draft Regulations could specify when these pots should be valued for the purpose of applying the de minimis.

Q2: Do you envisage any challenges for members and providers if the de minimis is applied to multiple pots within the same scheme?

13. There were 20 responses to this question, with respondents split evenly between those who do not foresee challenges in applying the de minimis across multiple pots, and those who do anticipate challenges ahead. Some providers told us that

they already have measures in place to charge members only once, rather than per pension pot.

14. For those respondents who do foresee challenges, a ranges of issues were highlighted. Four respondents said that member data quality, especially for pots that may have been deferred for a number of years, is likely to impede application of the de minimis across multiple pots. A couple of respondents said that members may be disadvantaged by combining multiple pots, which separately, are under the de minimis limit in value, but combined, have a value of over £100.

15. There were two respondents who asked for clarification regarding the application of the de minimis across multiple pension pots. For example, where someone has three pots within the same default arrangement, of varying sizes of say £4,000, £2,000 and £50, so in total, clearly exceeding the de minimis threshold, should the flat fee be charged pro rata across each pot, or should the flat fee only be charged to one or both of the two larger pots, avoiding further erosion of the £50 pot.

16. One respondent suggested that the de minimis should include a tolerance margin to accommodate market fluctuations, and that the de minimis should be applied at a fixed point. This latter point is supported by a number of other respondents.

Q3: Would proposed implementation in April 2022 create any business or operational challenges?

17. Of the 16 responses to this question, 12 respondents said that they could foresee business or operational challenges with an April 2022 implementation of the de minimis. The most common challenge raised was that of the implementation of multiple regulatory requirements, across broadly similar timescales during 2021 and 2022. This was a concern for nine respondents, who quoted examples of other regulatory measures including the introduction of simpler annual benefit statements, new Task Force on Climate Related Disclosures reporting requirements and a new value for money assessments for relevant schemes, as well as measures proposed in consultation exercises by the Financial Conduct Authority and The Pensions Regulator.

18. A further concern raised by five of the 12 respondents who identified business challenges, was that of IT and other business operation changes. Respondents told us that these changes need to reflect the granular detail of the de minimis regulations and can be complex and time consuming, so the earliest possible confirmation to industry of the final detail of the policy, guidance and regulations would be needed, to enable its implementation from April 2022. For this reason, it was suggested by some respondents that the government should consider a later implementation date for the de minimis.

19. An additional challenge highlighted several times in this consultation is that of loss making pension pots, where whilst a provider will see a reduction in income from a

small pension pot subject to the de minimis, that pot is also still subject to other charges, including the general levy.

Government Response / Next Steps

Proposal for de minimis to apply to active and deferred pots

20. There was overall support from respondents for the de minimis to apply to both active and deferred pension pots, and this will be the government's policy going forward. No changes are required to the Regulations as part of the Permitted Charges consultation to accommodate this policy position.

21. It was suggested in some responses that the government should increase the level of the de minimis to a figure above £100, as the current level may not make a significant impact on members' retirement outcomes. After implementation of the de minimis, we will monitor its impact. However, we stated in the Permitted Charges consultation, that any future change to the level of the de minimis will only be considered alongside any potential solutions to tackle the proliferation of small pots. This remains our position.

22. In our Permitted Charges consultation, we made clear that the de minimis will apply only to pension pots held within the default arrangement of certain occupational pension schemes. The rationale for this is that the de minimis is a limit on permitted charges that fall within the charge cap. We have no plans to extend the de minimis to defined contribution arrangements that fall outside of the scope of the charge cap.

23. It was suggested that greater clarity in the draft Regulations was required to limit the risks of market fluctuations impacting the correct application of the de minimis. We do not intend to amend the Regulations to prescribe the regularity or timing of periods when a member's rights should be valued, in order to determine whether the de minimis should be applied to those rights in the default arrangement. Instead we will address this point through non-statutory guidance, and recommend that valuation of rights should be undertaken at regular intervals of either monthly or annually, and that flat fees, where applicable, should be deducted on the day of valuation.

24. We acknowledge the comments made on the risks of cross subsidisation, however, we do not plan to address this through policy or regulatory change. It will be for providers to decide whether they feel it is necessary to adjust their charges to certain members, and we expect that they would consider the risks of any business impacts of this approach.

Challenges for members and providers if the de minimis is applied to multiple pots within the same scheme

25. We noted that several providers stated that they already had processes and systems in place to identify where a member may hold multiple pension pots, and this group did not foresee any challenges in this respect.

26. However, other respondents did highlight multiple pension pots as a concern. We know that consolidation of small pension pots would bring significant benefits to members and providers, including in respect of the application of the de minimis. Consolidation of small deferred pots in the Automatic Enrolment market will bring greater net benefits to members. However, further work is required by the industry working with government to look at cost/benefit analysis.

27. The Department is committed to supporting consolidation, particularly through our partnership with the Cross Industry Small Pots Coordination Group. This Group is progressing several strands of work, including on improved data matching, links with pensions dashboards and how the transfer of pension pots can be made more efficient. The Group published, an initial progress report[3] on 30 September. The key updates from this report for the different strands are outlined below:

    - The Consumer Detriment working group – has considered the potential benefits against the disadvantages of consolidating small, deferred pots for members and will quantify these benefits in the next phase of their work.
    - The Transfers working group – has mapped out member-initiated transfer processes to identify costs incurred during these transfers, potential barriers and efficiencies to facilitate low cost transfers.
    - The Data Standards working group – has mapped out data requirements and identified potential barriers to data matching, such as data availability and quality.
    - The Co-ordination Group – has identified commonalities between prospective small pots solutions and ongoing industry strategies and identified opportunities and possible barriers to achieving these aims.

28. Further clarity on how the de minimis should be applied more generally was also requested by some respondents. We will set out further examples of the operation of the de minimis in a revised version of our non-statutory guidance "*The charge cap: guidance for trustees and managers of occupational schemes"*, to be published alongside the Amendment Regulations.

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[3] Co-Ordination Group making good headway on small pots solution | Pensions and Lifetime Savings Association (plsa.co.uk)

Challenges to implementation in April 2022

29. A majority of respondents raised concerns about the timing of this measure, as it coincides broadly with implementation of other government measures, and the timescale for implementation, in particular to accommodate IT system changes. We have, and will continue to work closely with providers most impacted by this change, to give them the earliest possible notice of the final policy position regarding the operation of the de minimis.

30. However, we believe that it is important that members in scope benefit at the earliest opportunity from the protections offered by the de minimis, and so we will continue to implement this change from April 2022. Consequently, we do not plan to change the coming into force date of the Amendment Regulations.

Chapter 3: Statutory Instrument for the De minimis

Background

31. In the *Permitted Charges in Defined Contributions Pension Scheme* consultation exercise, we consulted on the draft Regulations to implement the de minimis.

32. We intend to bring this change into legislation via The Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2021, which will come into force on 6 April 2022 – subject to parliamentary approval, and which will amend the Occupational Pension Schemes (Charges and Governance) Regulations 2015.

Summary of original proposals in the Permitted Charges consultation

To amend the Occupational Pension Schemes (Charges and Governance) Regulations 2015 to permit flat fees to be levied only where the value of the member's rights under the default arrangement of occupational pension schemes in scope is more than £100.

The flat fee may only be levied either in full or partially, to the extent that it would not reduce the value of the member's rights to below £100.

The scope of the de minimis measure would only apply to the value of the member's right in the default arrangements of certain occupational pension schemes.

Stakeholder responses

Q4: Does the draft Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2021 achieve the policy intent for implementing the de minimis?

33. Of the 17 who responded to this question,15 agreed that the draft Regulations do achieve the policy intent. Several respondents said that discrepancies existed between the policy proposed in the consultation document and draft Regulations, and they have suggested that minor changes be made, in order to remove the risk of any uncertainly or misapplication of the de minimis.

34. Two respondents have also requested clarity on timing for the valuation of the de minimis and whether flat fee charges should be applied to members' rights at the point of valuation.

35. It was also suggested by one respondent, that within the draft Regulations, we consider changing the reference to flat fee charge in the 2015 Regulations. As the draft Regulations are currently written, that reference is to regulation 6(4)(a) of the 2015 Regulations, which refers to the £25 annual limit on flat fee charges. It was suggested that this reference should instead be to regulation 5(3)(b), which defines what the flat fee charge is.

36. A respondent further suggested that the proposed new regulation 6(5) in the draft Regulations which would require that members are charged only according to the value of their rights (i.e. the combined total value of the pension pots they hold with a provider), should be revised to accommodate operating practices which use a refunding or rebating system. The aim would be to address the short term overcharging of members, where they hold multiple pension pots, and are charged for each pot. This overcharging is then corrected, before the next pension pot valuation point, so that the charges attributed by the member reflect their rights.

37. A respondent also said that draft Regulations are not entirely clear on whether the de minimis only applies to pension pots within a provider's default arrangements. Another respondent asked that we consider whether paragraph 6 of the draft Regulations is explicit on the application of partial fees so they do not reduce the value of a member rights to less than the de minimis threshold.

Government Response / Next Steps

38. We will make the following amendments to the Amendment Regulations, as suggested by respondents:

- We will make it clearer that a proportion of a flat fee may be charged on the value of a member's rights, provided that proportion charge does not itself reduce the value of the member's rights to below £100.

- We will introduce a new provision to clarify that where a flat fee is deducted more than once per member per valuation period, within the same default fund, this will not be contrary to regulation 6 of the 2015 Regulations, provided that the relevant provider refunds or rebates any excess charge to the member, within a reasonable period of time (i.e. before the next valuation date).

39. Alongside the amending Regulations, we will publish a revised version of *The charge cap: guidance for trustees and managers of occupational schemes.* This revised guidance will describe how the de minimis will operate.

Chapter 4: Impacts of the de minimis

Background

40. Alongside publication of the Permitted Charges consultation document, we published a consultation stage regulatory impact assessment which outlined the impacts of the de minimis on flat fees. In this report, we have chosen to not summarise any data provided and instead this information will form part of the final regulatory impact assessment, which this Department will publish alongside the Amendment Regulations.

41. In preparation for the final stage regulatory impact assessment, we asked respondents for evidence on the financial costs and benefits of this measure to business and members.

Stakeholder responses

Q5: What are the full financial costs of adopting the de minimis for your business? Please outline which costs are one-off or ongoing. Please outline how many pots will be affected within your business and the types of members who own these pots below £100.

42. We asked about the financial costs associated with adopting the de minimis for businesses. Twelve pension providers answered this question, and of those six said that as they had no pension pots subject to flat fees in AE schemes there would likely be no cost to them. However, one response indicated there may be some indirect costs for these businesses, through any evidence requirements associated with compliance with the Regulations.

43. Five respondents, who answered this question, said that they managed pension pots that would be affected by the de minimis and therefore incur financial costs. The one-off costs highlighted included changing and testing of IT systems and programs, updating scheme documentation and communications with employers and members, to explain the operation of the de minimis. There were a number of factors mentioned in responses about how cost may differ, such as how much of the implementation could be automated or whether services were provided internally. One respondent mentioned potential costs to investment managers if annual management charges need to change to reflect the impact of the de minimis on a scheme.

44. The main ongoing cost mentioned was loss of revenue from no longer being able to levy flat fees on pension pots worth less than £100. One response mentioned the implications of losing out on revenue from smaller pension pots may result in greater cross-subsidisation between pots.

Q6: What are the non-financial or indirect impacts to businesses and members? Please outline how many pots will be affected within your business and the types of members who own these pots?

45. In general terms, the main theme repeated by five respondents in response to this question was that of the risk of cross subsidy across pension pots held by the same provider. The reduction in income from the smaller pension pots, where the de minimis has taken effect, may consequently lead providers to recoup that reduction in income by increasing fees to other members to whom the de minimis provision does not apply.

Q7: In introducing a de minimis the policy objective is not intended to inhibit scheme consolidation of multiple deferred small pots. Could you tell us if you think there would be any impact?

46. There was no consensus amongst respondents as to whether a de minimis would inhibit scheme consolidation. Of the 16 responses to this question, eight respondents were of the view that the de minimis would not inhibit small pension pot consolidation. For example, some respondents who currently charge a flat fee felt that their existing systems were able to identify multiple pots held by the same member, to facilitate consolidation, though it was also pointed out that member may have several pension pots with a provider, as a result of several concurrent employments, which would be inappropriate to aim to combine.

47. In total eight respondents did foresee risks to consolidation of multiple pots within the same scheme. Respondents said that incentives for member initiated consolidation could be diminished, as the de minimis would limit the financial impacts of charges for those with the smallest savings, and reduce pressure on members to address those impacts. Respondents also said that provider driven

consolidation may be impacted. For example, the de minimis limit may make some individuals' funds and the option for bulk scheme transfers between schemes less profitable to providers, who have limited charging options on certain pots.

Government Response / Next Steps

48. We are grateful to respondents for the additional information and evidence they have provided through this consultation exercise. The information we have gathered will be reflected within our final regulatory impact assessment.

Chapter 5: Moving to a Universal Charging Structure

Background

49. In our Permitted Charges consultation document, we described how the current three permitted charging structures used within the default arrangements of qualifying schemes, had worked well since their introduction, in offering opportunities for different groups of workers to benefit from automatic enrolment.

50. Equally, these charging structures brought flexibility to pension scheme providers for them to set charges which, whilst operating within the limits of the charge cap, have allowed them to meet the needs of different labour market sectors, including those which have high job churn, within their particular business model. The use of these structures however means that charges across other automatic enrolment pension products are less transparent than they could be, which in turn, limits a member's ability to compare charges across pension products.

51. The majority of members of occupational pension schemes used for automatic enrolment remain in the default arrangement provided by their employer, and this approach will continue to suit many employees going forward. However, over time, their financial circumstances and preferences may change, which creates an opportunity for them to consider whether their current pension arrangement, continues to meet their needs. We therefore used the consultation to look at how, through a simplified charging structure, employees could become more engaged with their pensions, and consider how they could better compare pension products, to ensure they have the right pension.

52. This consultation also considered the role of the employer, as they select the pension scheme used by their employees. Whilst employees can select the specific fund into which they contribute, few of them take this step. The employer may pay a fee to a new pension scheme provider for joining their scheme and are required by law to contribute to their employees' automatic enrolment pension a minimum of 3% of each employee's gross salary. Through this consultation we wanted to better understand employer policies toward their contributions to employees' pensions, in circumstances where an employee may wish to switch within their current provider's portfolio, or to another provider.

Summary of original proposal in the Permitted Charges consultation:

- Rationalise the current three permitted charging structures within the default fund arrangement, down to a single charging structure.
- That single charging structure would allow charging of a single percentage annual management charge, based on the value of the member's pot within the default fund.
- Combination charging would no longer be permitted.

Questions to stakeholders

Q8-15:

8. Do you think that members (in particular AE) have an understanding of your scheme costs and charges? If so, what evidence do you have to support this?

9. Does the current system impede members from carrying out a comparison of costs and charges between different schemes? If so should the system be reformed to allow for simple price comparison of costs and charges?

10. Do you agree that the government should move to a universal charging structure within the default fund arrangement? If so how best could the government implement this change in order to manage the impact on the industry and members?

11. What are the benefits of standardisation for other government initiatives such as simpler statements and the pensions dashboard?

12. Are there other ways, besides changing the charging structure, that could make a significant difference to member comprehension of charges and encourage improved member engagement?

13. What other risks exist for members who may choose to make decisions on which occupational pension scheme they should save into, based purely on the level of the charges they may pay?

14. Will this proposal to move to a single charging structure change the way employers select the pension scheme they use for automatic enrolment and would an employer continue to pay their 3% minimum contribution if the employee decides to move their pension savings to a different provider?

15. Do employers who are choosing a pension scheme routinely negotiate the level of their own charges with the provider, and if so what impact may this have on the employee's contributions?

Government Response / Next Steps

53. The majority of respondents to the consultation exercise, did respond to questions 8 to 15 above. However, we have not set out a detailed summary of the responses to these questions, in this government response. Nor at this time, are we setting out any recommendations or next steps, in respect of the responses we have received to these questions. However, some of the key points that respondents told us are:

- A majority of respondents agreed that in general, members of AE schemes, do not have an understanding of their costs and charges. Although some pension providers did think that their own charging structure and way of presenting charges (including in pounds and pence) was clear to their members.

- A majority of respondents agreed that the current charging system impedes members' comparison of pension products, between different pensions and schemes. Several respondents said that in view of inertia, it was more important for the employer to be able to compare charges between schemes. Other comments included that more emphasis should be placed on the returns that members may achieve from a pension, rather than on the charges that they may pay.

- There was a broad majority against the proposal to move to a universal charging structure. Many respondents agreed that it would support improved transparency of charges, and clearer member communications through greater simplicity of charges information on pension statements. However, other respondents stated that the market is still immature, and this measure could lead to fewer providers offering pensions in the AE market. This in turn could reduce diversity of both products and investment policies. A number of respondents stated that increasing member choice may have implications for the continued success of AE, which has relied on inertia to ensure members are invested in well-designed default schemes.

- There were also a number of respondents who cited member inertia as a more significant barrier to members understanding charges, rather than the structure of those charges. It was suggested that a government priority should be to improve member engagement and address current inertia, before any measures to simplify charges are implemented, and that where charges are presented to members, this is done in a consistent manner, such as in pounds and pence.

54. We intend to consider the evidence received in response to question 8 to 15, in more detail before making any policy decisions and we will also continue to be receptive to emerging new evidence concerning improvements to transparency of member charges, and costs comparability, and will consider such evidence, alongside the responses to this consultation.

55. We will publish our response to questions 8 to 15 of this consultation exercise, and our proposed next steps, in a separate response, shortly.

Annex A: List of respondents

Aegon

Age UK

Association of British Insurers (ABI)

Association of Consulting Actuaries (ACA)

Association of Pension Lawyers (APL)

Aviva

Barnett-Waddingham LLP

Creative AE

Federation of Small Businesses

Financial Services Consumer Panel

Hargreaves Lansdown

Interactive Investors Services Limited

Mercer

Nest

Now Pensions

Pension Administration Standards Association

PensionBee

Pensions Policy Institute

Phoenix Group

The Pensions and Lifetime Savings Association (PLSA)

Prospect

Royal London

Sackers

Scottish Widows

Smart Pension

Super Trust Ltd

The Investing and Saving Alliance

The People's Pension

The Society of Pension Professionals

Which?

Willis Towers Watson

One individual respondent