Department for Work & Pensions

Public consultation

# Better workplace pensions: a consultation on charging

Presented to Parliament by the Secretary of State for Work and Pensions by Command of Her Majesty
October 2013

Cm 8737

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## Contents

# Foreword by the Minister of State for Pensions

Automatic enrolment is changing the way people in the United Kingdom save for their retirement. After the first year of our workplace pension reforms, 1.7 million people have been enrolled in a pension and we estimate that over 90 per cent have remained in their scheme. This should give everyone confidence that when the reforms are extended to cover small and medium-sized employers (SMEs), participation rates will remain high.

At the same time our work continues to ensure that those workplace schemes used for automatic enrolment are of good quality: well governed, well administered and with clear charges for members, offering value for money. In July 2013 we launched a call for evidence on several important aspects of scheme quality – governance, administration, investment and scale. We received detailed responses from a wide variety of our stakeholders. We will bring forward proposals in these areas in due course.

In May I signalled the Government's intention to consult further on the issue of charges in workplace schemes. As the Office of Fair Trading noted in its recent report *Defined contribution workplace pension market study*, a weak demand side in a complex market has the potential to prevent some members from benefiting from price competition. While I am pleased that some large employers setting up schemes for automatic enrolment are getting good deals for their employees, there is a real risk that SMEs will struggle to negotiate the same low charges or will use high-charging legacy schemes. When small differences in charges can make a significant difference to final retirement incomes this is an area where we cannot afford to be complacent.

Therefore, through this consultation, we want to assess what can be done to improve transparency in pension scheme charges and to look at whether there is a role for the Government in improving disclosure. We also want to test the case for capping default fund charges and have offered a range of structures to help tease out some of the various issues. We look forward to receiving your views on these important questions.

**Steve Webb, MP**
Minister of State for Pensions

# Executive summary

1. Automatic enrolment is transforming our savings culture by encouraging and supporting millions of people at risk of a poorer retirement to take personal responsibility and save for their future. The Government expects that this will result in six to nine million people newly saving or saving more, generating an extra £11 billion a year in pension saving.

2. The initial signs are promising with 1.7 million workers enrolled and opt out far lower than expected.[1] Previous research suggested around a third of people would opt out, but the latest research with large employers indicates that around 91 per cent of individuals are choosing to continue to save.[2]

3. This Government is also legislating, subject to approval by Parliament, to introduce a system of automatic transfers to help people to better keep track of their workplace pension savings and ensure they reap the benefits of consolidation.

4. The majority of people being automatically enrolled are likely to join the default fund in defined contribution (DC) schemes. It is, therefore, important to ensure that these schemes deliver the best possible value for money. Also, people must be confident that as much of the money they save as possible goes towards boosting their retirement income.

5. The impact of the charges levied on people's pensions savings over their lifetime can be significant – seemingly small variations in charges can result in a considerable difference in people's final retirement savings.

[1] http://www.thepensionsregulator.gov.uk/docs/automatic-enrolment-monthly-registration-report-2013.pdf
[2] https://www.gov.uk/government/publications/automatic-enrolment-opt-out-rates-findings-from-research-with-large-employers

## Market failures in pensions

6. In January 2013, the Office of Fair Trading (OFT) launched a market study into DC workplace pensions. In September, this concluded that competition alone cannot be relied upon to drive value for money in the DC pensions market. This is due to two main factors:

   - **The buyer side of the market**, which the OFT described as one of the weakest they had analysed in recent years:[3] scheme members rely on employers to select a scheme, and few schemes have sufficiently good quality, independent governance to provide proper scrutiny.
   - **The complexity of the product**, which creates difficulties in making comparisons around costs and quality because outcomes may not be judged for a number of years.

7. Automatic enrolment has corrected some buyer-side failures, but it does not address all the market failures that exist. In other well-functioning markets, the ultimate beneficiary of the product is responsible for its selection. The arrangement in automatic enrolment, however, is a clear example of a principal-agent problem: the employer (the agent) may not always act in the best interests of the employee (the principal) when choosing a pension scheme. This could result in employees paying excessive charges for their workplace pension scheme.

8. There is evidence that charges have fallen in recent years, but low charges are not a reality for all pension savers. The OFT raised concerns about 'legacy' schemes sold prior to 2001. Charges are currently around 26 per cent higher in these schemes than those sold after 2001 and the OFT indicated a significant proportion of these schemes are open to automatic enrolment.

9. While large employers have been able to secure schemes with low charges for their employees, there is no guarantee that this trend will continue when automatic enrolment begins for SMEs from April 2014.

10. The risk that individuals may face high charges grows for those employed by SMEs, whose schemes typically have higher charges.[4] Evidence suggests that size can affect an employer's ability to drive competition[5]; smaller employers may lack the resources and understanding to achieve similar outcomes for their employees. It is vital that these employers are clear about the sorts of charging levels that represent reasonable value for their employees.

11. This consultation examines whether the pensions industry can be relied on to address the issues identified by the OFT, or whether it would be necessary for the Government to intervene in some way to protect people from being enrolled into schemes which have high charges.

## Intervention to address market failures

12. We are bringing forward proposals on a range of measures to tackle these issues and this consultation is focused purely on the issue of pension charges. A wider Department for Work and Pensions (DWP) call for evidence on the issue of scheme quality closed to responses in September. This considered the issue of scheme governance highlighted by the OFT and we intend to provide a fuller response on our proposals in these areas by the end of the year.

13. We welcome views on the following proposals.

[3] Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown.
[4] Wood *et al.*, 2013, *Pension Landscape and Charging: Quantitative and qualitative research with employers and pension providers*, Crown, p43.
[5] Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p114.

### Improved disclosure of information about charges

14. A number of voluntary industry initiatives seeking to improve disclosure of charges information to scheme members and employers have been launched in an effort to reduce the complexity of the product. The Government welcomes these initiatives, but is interested in views on whether further action is required. There are a number of potential options:

- **Mandating disclosure to members** by widening the disclosure requirements, to include information about charges, on all providers and scheme managers in respect of the basic scheme information and annual benefit statement. This would ensure a consistent approach across all scheme members.
- **Standardising disclosure to employers** to introduce a standard framework for the disclosure of costs and charges, and the services provided at the point of sale through a code of conduct and on an ongoing basis by mandating information provided to employers.
- **Disclosure of transaction costs** – require disclosure to members, employers, as well as trustees, and independent governance committees (as recommended by the OFT).

### Action to address high or unfair pension charges

15. There is evidence to suggest that information alone may not act to correct the incentive problems that exist in this market and some employers will struggle to act on any information they receive. Therefore the Government is interested in hearing views on whether:

- **A cap on pension scheme charges should be introduced** for all members, both active and deferred, of default funds in qualifying DC schemes for those employers staging from April 2014. This cap would then be extended to capture all employers who have staged from October 2012 up to and including March 2014 by April 2015. The Government is considering three options for capping charges:
  - **Option 1: A charge cap of 1 per cent of funds under management**, reflecting the current stakeholder pension cap.[6]
  - **Option 2: A lower charge cap of 0.75 per cent of funds under management**, reflecting the charging levels already being achieved by many schemes.
  - **Option 3: A two-tier 'comply or explain' cap**. There would be a standard cap of 0.75 per cent of funds under management for all default funds in DC qualifying schemes. A higher cap of 1 per cent would be available to employers who explained to the Pensions Regulator the reason for charges in excess of 0.75 per cent.
- **Differential charging between active and deferred members should be banned in DC qualifying schemes**: this would address active member discounts (AMDs) and prevent a similar practice whereby scheme members are moved to an individual personal pension with higher charges when they leave employment and stop making contributions. This ban could take effect for schemes put in place for employers staging from April 2014. We are interested in views on transitional arrangements for dealing with schemes in place prior to this date.

[6] For new members from 6 April 2005, the charge cap is 1.5 per cent per annum, reducing to 1 per cent after 10 years of continuous membership in the scheme.

- **The ban on consultancy charges should be extended from AE schemes to all qualifying DC schemes**. Since September 2013, the use of consultancy charges in automatic enrolment schemes has been banned following a review which found they posed a significant risk of scheme member detriment. This ban does not encompass members of qualifying schemes, however, and so we may look to extend it.[7] It is important to ensure all savers are protected, so we are considering how to extend the consultancy charges ban.
- **Adviser commissions set up prior to the introduction of the Retail Distribution Review should be banned in qualifying schemes**. The OFT raised concerns that schemes containing built-in adviser commissions may continue to be used for current members, as well as being used for people automatically enrolled in the coming years. These commissions may lead to scheme member detriment, because they create barriers to switching between schemes. We would be interested in receiving evidence on the impacts of any such measure.

## Legacy schemes

16. The OFT identified £30 billion of savers' money in contract and bundled trust-based schemes with charges at risk of being poor value for money. In response, the Association of British Insurers (ABI), and those of their members that provide contract-based DC pensions, have agreed to carry out an audit of 'at risk' schemes covering all workplace pension products sold pre-2001 and all post 2001 workplace pension products with charges over an equivalent of 1 per cent annual management charge (AMC). The purpose is to establish both the level of charges, and any benefits associated with them, to assess whether members are receiving value for money.

17. The Pensions Regulator is also working on proposals to allow trustees to assess value for money in small trust-based schemes, and for those schemes to provide data on those assessments.

18. We will continue to work closely with both the OFT and the Pensions Regulator as this audit is taken forward. The Pensions Bill 2013–14 includes powers to set minimum quality standards on workplace pension schemes, including to limit charges in these schemes. Once this work is complete we will consider whether any further action is required to deal with the issues identified by the OFT.

## Next steps

19. Chapter 5 sets out the consultation process and summarises the consultation questions. This consultation closes on 28 November 2013. We will follow this consultation with government proposals on both charges and scheme quality.

[7] While all automatic enrolment schemes are qualifying schemes, only some qualifying schemes are automatic enrolment schemes. A **qualifying scheme** is a tax-registered, occupational or personal pension scheme that satisfies the minimum contribution requirements for automatic enrolment. Such schemes may have been in existence prior to the introduction of automatic enrolment. An **automatic enrolment scheme** is a qualifying scheme specifically set up for automatic enrolment that will accept anyone who is automatically enrolled or opts in. The scheme does not require anyone to express a choice or provide information to become, or remain, an active member.

# Why do charges matter 1

1.1 Twelve million people are not saving enough to ensure an adequate income in retirement[8] and the number of employees saving into a workplace pension has declined from 12.9 million in 1997 to 12.1 million in 2012.[9]

1.2 Automatic enrolment means many people will be saving for the first time. Most of those automatically enrolled will start saving into a DC pension scheme. The charges levied, often varying significantly between schemes, cover the cost of services such as setting up and administering the pension, fund management and scheme governance.

1.3 We expect the majority joining DC schemes will go into the default fund and the options in this consultation address concerns about this group – in part because they will not make any active choices about their pension saving, and also because they may have very little awareness or understanding of the charges they will end up paying.

1.4 While there have been encouraging signs of progress, there are still issues of concerns in respect of pension charges. These need to be addressed to ensure any bad practice, either by a minority or from practices no longer relevant in a world of automatic enrolment, do not undermine trust in the system. We want to ensure that as much of the money as possible that people pay into their pensions goes towards their retirement income.

1.5 The average individual moves jobs eleven times during their working life and could therefore end up with eight small and ineffective pension pots.[10] Therefore we are legislating for a pot-follows-member system of automatic transfers as part of the Pensions Bill 2013-14. This would allow individuals to take their pension savings with them as they move jobs. This makes it all the more important that all workplace DC pensions meet the minimum quality standards, to reduce the risk of detriment.

[8] Department for Work and Pensions, 2013, *Framework for the analysis of future pension incomes*, Department for Work and Pensions. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/239641/framework-analysis-future-pension-incomes.pdf

[9] Office of National Statistics, 2012, *Annual Survey of Hours and Earnings*.

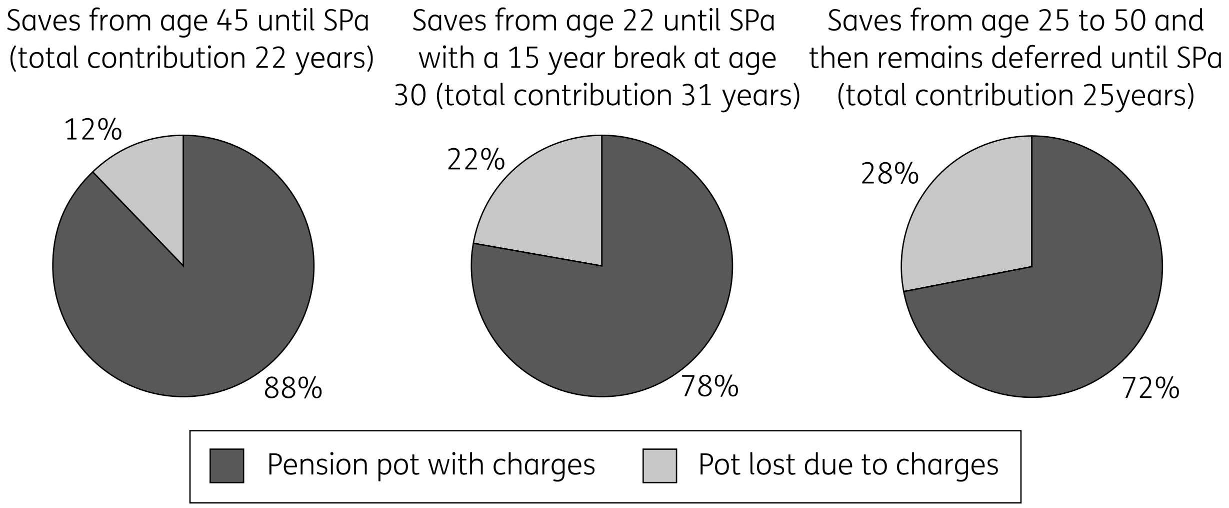
[10] Johnson P, Yendle D and Boulding A, 2010, *Making automatic enrolment work – A review for the Department for Work and Pensions*, Cm 7954, TSO.

## The impact of charges

1.6 While the percentage taken in charges may, on the surface, appear small, as the value of an individual's pension pot grows over time the cumulative impact can be significant.

1.7 The effect will depend on a range of factors, including the amount of time the individual saves into a pension, the level and persistency of contributions, and the level of investment returns. Figure 1 shows the effect of a 1 per cent charge on funds under management on different individuals. An individual who saves from age 45 until State Pension age could lose 12 per cent of their pot, whilst an individual who saves between the ages of 25 to 50 (and who remains deferred in their scheme until retirement) could lose 28 per cent of their pension pot.[11]

**Figure 1: Potential loss in pension saving from a 1 per cent charge on funds under management**




Source: DWP modelling

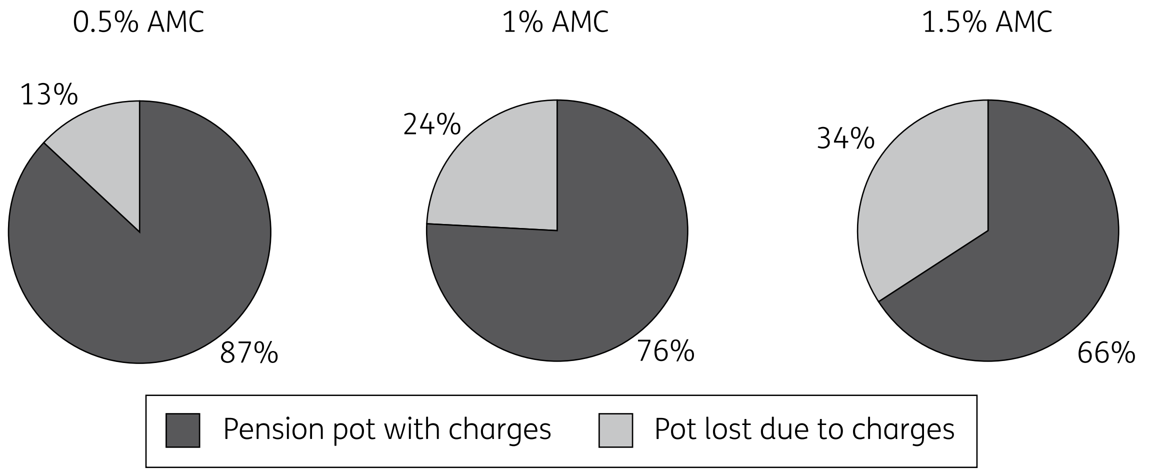
Assumptions:
1. Initial annual contribution: £1,200
2. Investment growth: 7.00%
3. Annual contributions growth: 4.00%
4. State Pension age (SPa) of 68 – except for the individual who starts saving from age 45, who is assumed to reach SPa at age 67 (in line with government proposals).

1.8 Seemingly small variations in charging levels can result in considerable differences in the amount of pension savings achieved.

1.9 Figure 2 shows that an individual who saves throughout their working life into a scheme with a 0.5 per cent AMC could lose 13 per cent of their pension pot from charges. By contrast, at the 1 per cent level, the individual could lose almost a quarter of their pot (24 per cent), and at the 1.5 per cent level could lose around a third (34 per cent).

[11] Compared to a situation with no charges.

**Figure 2: Impact of different charge levels on an individual who saves throughout their working life (46 years)**




Source: DWP modelling

Assumptions:

1. Initial annual contribution: £1,200
2. Investment growth: 7.00%
3. Annual contributions growth: 4.00%
4. Individual saves from age 22 to State Pension age (SPa) of 68 (in line with Government proposals)

1.10 These percentages can equate to considerable amounts of money – as demonstrated in Table 1 – which sets out the impact that different charge levels could have on the cash value of the private pension pot that an individual will end up with in retirement.

1.11 In the case of someone who saves throughout their working life, they could end up losing almost £170,000 from their pot with a 1 per cent charge, and over £230,000 with a 1.5 per cent charge.

1.12 The same individual could end up having considerably more money in their pot with a lower charge: an additional £66,000 at retirement with a 1 per cent charge, and an extra £100,000 with a 0.75 per cent charge – compared to a 1.5 per cent charge.

**Table 1: Impact of different charge levels and savings history on pension pots (values in nominal cash terms)**

| | AMC (%) | Pension pot without charges | Pension pot with charges | Cash lost with charge |
|---|---|---|---|---|
| **Individual A** Saves throughout their working life (46 contribution years) | 0.50 | £701,800 | £610,000 | £91,800 |
| | 0.75 | £701,800 | £569,500 | £132,300 |
| | 1 | £701,800 | £532,100 | £169,700 |
| | 1.25 | £701,800 | £497,600 | £204,200 |
| | 1.50 | £701,800 | £465,800 | £236,000 |
| **Individual B** Saves from age 45 until SPa (total contribution 22 years) | 0.50 | £88,200 | £82,800 | £5,400 |
| | 0.75 | £88,200 | £80,300 | £7,900 |
| | 1 | £88,200 | £77,800 | £10,400 |
| | 1.25 | £88,200 | £75,500 | £12,700 |
| | 1.50 | £88,200 | £73,200 | £15,000 |
| **Individual C** Saves from age 22 until SPa, with a 15 year break at age 30 (total contribution 31 years) | 0.50 | £435,800 | £382,800 | £53,000 |
| | 0.75 | £435,800 | £359,500 | £76,200 |
| | 1 | £435,800 | £338,100 | £97,600 |
| | 1.25 | £435,800 | £318,400 | £117,400 |
| | 1.50 | £435,800 | £300,300 | £135,500 |
| **Individual D** Saves from age 25 to 50 and then remains deferred until SPa (total contribution 25 years) | 0.50 | £399,500 | £339,700 | £59,800 |
| | 0.75 | £399,500 | £313,300 | £86,200 |
| | 1 | £399,500 | £289,000 | £110,500 |
| | 1.25 | £399,500 | £266,600 | £132,900 |
| | 1.50 | £399,500 | £246,000 | £153,500 |

Source: DWP modelling.

Notes:

1. Initial annual contribution: £1,200.
2. Investment growth: 7.00%.
3. Annual contributions growth: 4.00%.
4. State Pension age (SPa) of 68 – except Individual B who is assumed to reach SPa at age 67 (in line with government proposals).
5. Values are rounded to the nearest £100, and as a result may not sum.

## Trends in charging

1.13 There is evidence that charges in workplace pensions have fallen over time. The recent OFT market study into workplace DC pensions found that the average charge level in new contract-based schemes and bundled[12] trust schemes fell from 0.79 per cent for schemes set up in 2001 to 0.51 per cent for schemes set up in 2012.[13]

1.14 There are several possible reasons for this: government intervention in the market with the introduction of the stakeholder price cap in 2001 may have put downward pressure on charges by creating a 'price ceiling'.[14] More recently, we have seen prices decrease further and it may be the case that some of the low charging multi-employer schemes with charges equivalent to a 0.5 per cent of funds under management have acted as an even lower benchmark.[15]

1.15 The OFT has suggested that, in addition to the impact of government intervention, prices may have fallen due to the increasing level of assets under management over time, the modernisation of back office systems, and the decision of some providers to stop paying adviser commission in advance of the ban on this practice in January 2013.[16]

1.16 However, although there is some evidence of a trend towards lower charges in newly set-up schemes, there is still a wide range of charges in the market with some high outliers. The latest DWP charges survey found that 10 per cent of employers with contract-based schemes and 6 per cent with trust-based schemes reported an AMC of more than 1 per cent.[17] Meanwhile, the ABI found a small handful of schemes charging above 2 per cent.[18] The OFT estimates that approximately 186,000 pension pots with £2.65 billion in assets are in schemes with an AMC above 1 per cent.[19]

1.17 Moreover, the existence of a charging structure known as an 'Active Member Discount' (AMD) in many schemes means that those members no longer paying contributions (deferred members) pay on average 0.47 percentage points more than active members. The OFT estimates that there are currently around 10,000 contract-based schemes with AMDs, containing around £13.4 billion in assets.

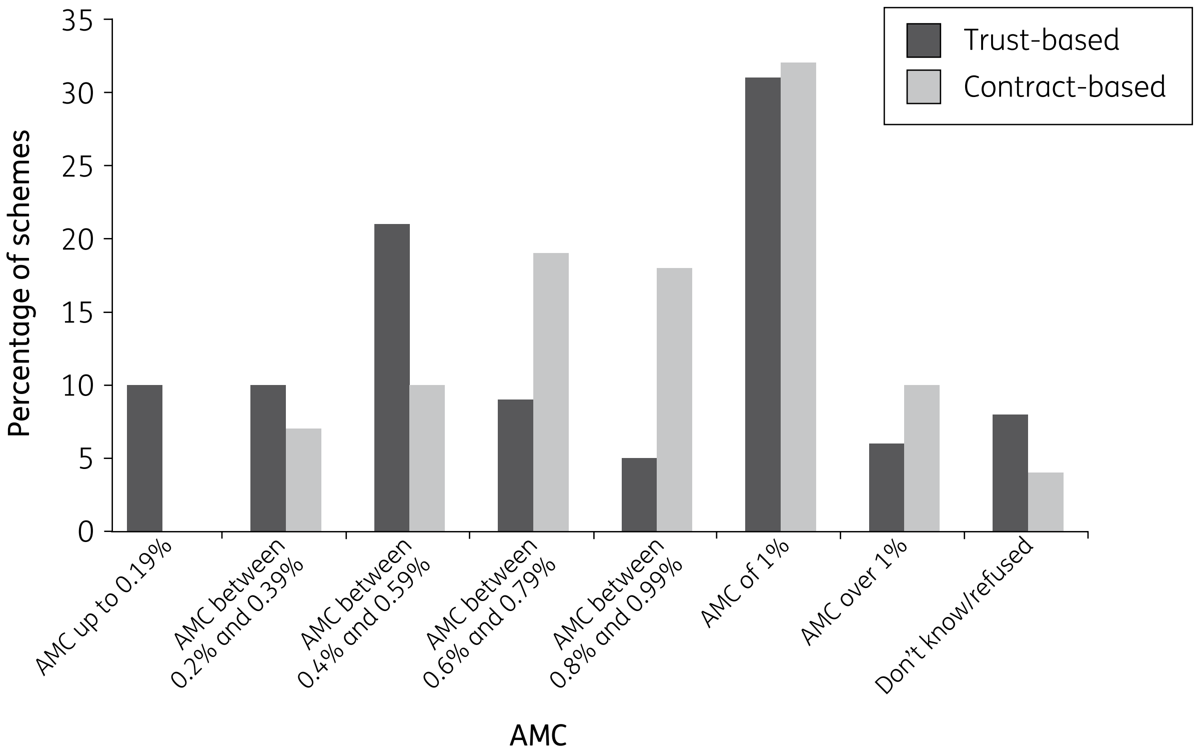
1.18 Clearly, not all pension savers are subject to low charges.[20] As the OFT demonstrated in their report, while large employers may be able to negotiate value for money charges for their employees, SMEs could lack the resources and expertise to do this, resulting in higher charges for those individuals.

[12] Pension schemes where the pension provider also administers the scheme.
[13] OFT explain in their report that this figure is not directly comparable to DWP's because DWP used a simple average AMC across schemes whilst OFT used a weighted average AMC across scheme assets. This means the OFT figures place a higher weight on the AMC of schemes with more assets under management.
[14] Wood *et al.*, 2009, *Current practices in the workplace personal pension market: Qualitative research with pension providers and intermediaries*, DWP Research Report 591.
[15] Wood *et al.*, 2012, *Pension landscape and charging: Quantitative and qualitative research with employers and pension providers*, RR804, Department for Work and Pensions, p44.
[16] Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown.
[17] This relates to contract- and trust-based schemes where respondents reported that members pay charges as a percentage of the fund. A small proportion of these employers said that they did not know the level of the charges their members paid, or refused to say – at least some of these are also likely to have charges above 1 per cent.
[18] Association of British Insurers, 2012, *Time to Act: Tackling our savings problem and building a better future*, ABI, p12.
[19] Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p103.
[20] Wood *et al.*, 2012, *Pension landscape and charging: Quantitative and qualitative research with employers and pension providers*, RR804, Department for Work and Pensions.

1.19 The OFT also found that charges in older legacy schemes, set up prior to the introduction of stakeholder in 2001, are at risk of being out of kilter with levels of newer schemes, because of the way in which schemes are individually priced and low levels of switching.[21] A significant proportion of these schemes are open to automatic enrolment, leaving a risk that employees will be enrolled into schemes with higher charges.[22]

1.20 While the deals being offered to the largest, most profitable employers appear to be competitive, concerns have been raised that this may be because some providers are loss leading to attract business. There is nothing currently in place to prevent charges from rising in the future, with the weak demand side in this market unfit to deal with this risk of scheme member detriment.

**Figure 3: Range of AMCs paid by members of trust- and contract-based schemes**




Source: Wood *et al.*, 2012, *Pension landscape and charging: Quantitative and qualitative research with employers and pension providers*, RR804, Department for Work and Pensions

## Conclusions

1.21 The Government has introduced automatic enrolment to ensure higher levels of workplace pension saving and higher retirement incomes in the future. The current Pensions Bill includes provisions to introduce a system of automatic transfers to ensure individuals can benefit from greater consolidation of their savings throughout their working life.

1.22 To ensure everyone can achieve adequate retirement incomes in the future it is crucial that employers and individuals, particularly those in default funds, have trust in private pensions.

21 Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p115.

22 From the OFT sample, 22,886 schemes set up prior to 2001 are open to automatic enrolment and are accepting new members. This equates to 25.6 per cent of the current schemes in the market that are open to automatic enrolment and accepting new members. Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p117.

# Market failures in pensions

# 2

2.1 The Government rarely seeks to intervene to set the price in specific markets unless there is sufficient justification in terms of failures in market structure and a lack of competition, resulting in consumer detriment.

2.2 In January 2013, the OFT launched a market study into DC workplace pensions. In September, this concluded that competition alone could not be relied upon to drive value for money for all savers in the DC pensions market and described the buyer side of the market as one of the weakest they had analysed in recent years.[23]

2.3 This chapter explores some of the key areas of concern in the pensions market, including difficulties arising from the complexity of charging practices as well as the demand side failures.

2.4 It also assesses the extent to which the pensions industry may act to address these issues and whether there is a strong case for government intervention.

## The complexity of the product

2.5 As the Work and Pensions Select Committee (WPSC) pointed out, a confusing array of costs and charges are applied in DC pensions.[24] Indeed, the OFT found 18 different names for charges that can be paid by members.[25] This complexity makes it difficult for employers and individuals to understand both the level and the effect of charges.

[23] Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p15.
[24] WPSC, *Improving governance and best practice in workplace pensions, sixth report of session 2012-13*,Parliament Publications, p3.
[25] Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p19.

## Comparability and consistency in charging

2.6 There is no standard definition of the component services and activities included within the headline charge quoted for each DC scheme. This makes direct comparison of charge levels difficult, which is problematic for employers who wish to shop around. As the OFT found, this weakens the effectiveness of competition in the market.[26]

2.7 There are also problems with the visibility of charges. Some providers refer to the 'Total Expense Ratio' (TER) separately to their headline charge. The TER sets out a broader definition of the array of different charges which may be taken annually as a percentage of the funds they manage, for example, custodial fees. These charges may be disclosed, but most individuals and employers appear to be unaware of the difference between the headline charge quoted and the TER.[27]

2.8 There are also additional charges, outside the TER, which may not be disclosed. These include transaction costs (the cost of trading funds) such as investment charges, brokerage commissions and bid-offer spreads. The OFT raised concerns that these non-visible charges add to the potential for conflicts of interest in the supply chain, such that charges may not always be managed in the interests of scheme members.[28]

2.9 Members of some schemes set up before the Retail Distribution Review (RDR) came into effect may pay adviser commissions. There is substantial variation in the way in these commissions were made and disclosed, and they are not necessarily captured in the headline charge or TER.

## Variations in charging structure

2.10 Differences in the charging structure between schemes and members can also make comparison difficult, leaving employers and individuals unsure as to whether they are getting a good deal.

2.11 Most DC schemes (61 per cent of contract-based and 67 per cent of trust-based schemes[29]) take a percentage of funds under management annually to offset costs.[30] This approach is commonly known as the AMC, but it only enables comparison across schemes when there are no charges excluded.

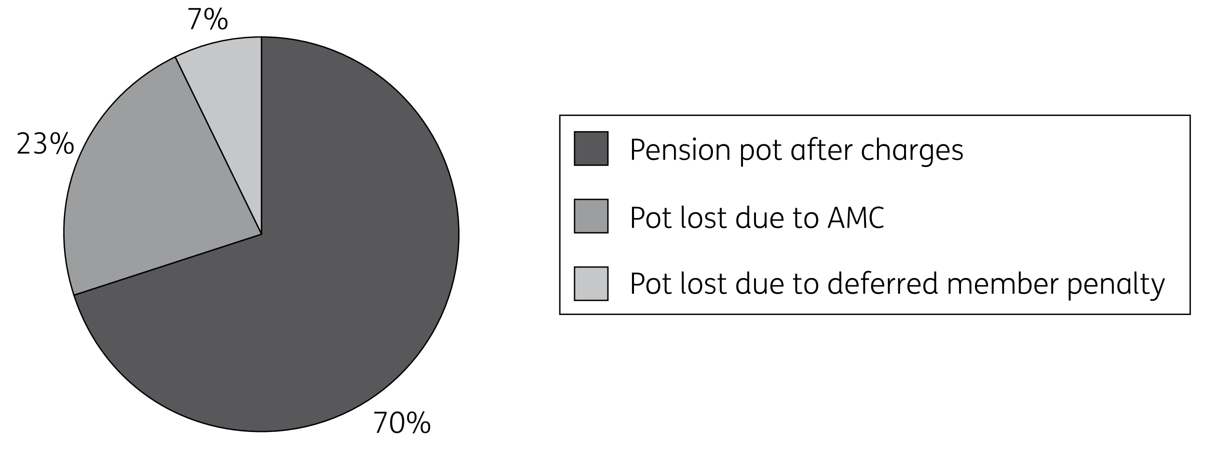
2.12 A minority of schemes charge a separate fee,[31] sometimes in addition to the AMC, for example, a contribution charge or a flat fee. This form of charging may have some benefits to scheme members[32] and has enabled new providers to enter the market. Again, this adds to the difficulty in comparing schemes.

[26] Ibid, p19.
[27] Wood *et al.*, 2012, *Pension landscape and charging: Quantitative and qualitative research with employers and pension providers*, RR804, Department for Work and Pensions.
[28] Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p18.
[29] Wood *et al.*, 2012, *Pension landscape and charging: Quantitative and qualitative research with employers and pension providers*, RR804, Department for Work and Pensions.
[30] The predominant headline charging structure now used by industry is the AMC, because of two factors; the introduction of stakeholder pensions in 2001 and the effect of the Financial Services Authority's (FSA's) RU64 regulation. The FSA's RU64 regulation required financial advisers recommending personal pensions to explain in the 'suitability letter' why this product was at least as good as a stakeholder pension.
[31] According to the 2011 DWP charges survey; for employers with trust-based schemes who knew their members' charges, a small proportion (14 per cent) reported charging as a percentage of members' contributions, with fewer still (8 per cent) reporting a flat fee charge per member. Amongst employers with contract-based schemes who knew their members' charges, 21 per cent reported that contribution-based charging was in place, and 4 per cent reported a flat-fee per member.
[32] For example, by allowing schemes to recoup set up costs more quickly, it can reduce the level of the AMC and the charges individuals incur over the longer term.

2.13 The OFT and the WPSC have both raised concerns about the practice in which some schemes levy a different level of charge depending upon whether an individual is still contributing to the scheme. This practice is most commonly known as an AMD. The OFT estimates that there are currently 9,800 contract-based schemes with AMDs, containing around £13.4 billion in assets. On average the OFT has found that members of these schemes can expect their AMC to increase by 0.47 percentage points if they stop contributing.[33]

2.14 Figure 4 shows the additional impact a deferred member penalty can have on the pension savings of an individual who is an active member of a scheme for 10 years and remains a deferred member for a further 20 years. This is based on a 1 per cent AMC which increases to 1.5 per cent when the individual stops contributing.

**Figure 4: Illustrative impact of a deferred member penalty on an individual's pension pot**




Source: Based on DWP modelling

Notes:
1. Based on an individual who saves for 10 years, and remains deferred for a further 20 years.
2. Initial total annual contribution: £1,200
3. Nominal investment growth: 7.00%
4. Total annual contributions growth: 4.00%

## Disclosure and its effectiveness

2.15 One suggested solution to these problems is to improve the disclosure and transparency of charges, ensuring people receive clear, consistent information.

2.16 DWP research shows that it is important that people feel in control – providing clear information can help achieve this.[34] As with other financial services, people expect to receive, or be able to look up, the information they get from their pension scheme. This is why we regulate for all schemes to provide certain information to members.[35]

[33] Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p20.
[34] Gray *et al.*, 2008, *Why people may decide to remain in or opt out of personal accounts: Report of a qualitative study*, DWP Research Report 551.
[35] Department for Work and Pensions, 2013, *The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations*, Department for Work and Pensions.

2.17 In 2011, DWP published guidance on default funds for automatic enrolment schemes.[36] This specified that a clear breakdown of charges should be provided illustrating the likely effect of these charges on final retirement outcomes.

2.18 Standardised information could make comparison of charges easier, which would in turn reduce the costs to employers of selecting a scheme. National Association of Pension Funds (NAPF) research[37] found that employers showed a strong interest in the concept of a standardised guide to pension charges – particularly among the smallest employers who saw it as a useful starting point in selecting a provider.

2.19 Work to ensure that all pension charges are reported comprehensively and consistently is at an early stage. A number of voluntary industry initiatives have been launched in the past 18 months:

- The **joint industry code of conduct on charges**, launched in late 2012, sets standards for information to employers. This requires that all charges are clearly and accurately stated in writing before the employer makes a choice, with a standard template summarising the services provided. This is supported by a web tool, available on the Pensions Advisery Service website,[38] to aid employer understanding of the impact of charges.
- In January 2013, **the ABI announced that 14 of its members had agreed voluntary standards for disclosing charges to scheme members**. This initiative will be implemented for new schemes by summer 2014 and older schemes by the end of 2015. Signatories are committed to disclosing all charges and costs in a consistent way, from the outset and annually. Eventually this initiative will cover the vast majority of members of contract-based schemes. It is yet to be taken up by trust-based schemes.
- In September 2012, **the Investment Management Association (IMA) published Enhanced disclosure of fund charges and costs**, which provides guidance to investors. It sets out the regulatory standards and additional recommended best practice for the disclosure of fund charges and costs. This is voluntary, only applies to UK-authorised funds, and therefore does not cover all funds in which DC default funds may be invested. The IMA recently consulted on the introduction of a new Statement of Recommended Practice (SORP), for the financial statements of UK-authorised funds which will include more comprehensive disclosure of fund performance and charges and, in particular, transaction costs.

2.20 These initiatives may help improve transparency; the industry has a key role to play in ensuring that disclosure is comprehensive and implemented in a way that meets members' needs.

2.21 However, the WPSC has raised concerns about the lack of enforceability of these codes and the lengthy timeline for fully implementing them.[39]

[36] Department for Work and Pensions, 2011, *Guidance for offering a default option for defined contribution automatic enrolment pension schemes*, Department for Work and Pensions.
[37] NAPF, 2012, *Pension Charges Made Clear: Join Industry Code of Conduct*, NAPF.
[38] http://www.pensionsadvisoryservice.org.uk/online-planners
[39] Work and Pensions Select Committee, 2013, *Improving governance and best practice in workplace pensions, sixth report of session 2012-13*, Parliament Publications, p24.

**Consultation question**

1. **We would welcome views and evidence on the effectiveness of these initiatives and the extent to which the industry discloses charges upfront, in a consistent manner, to members and employers.**

2.22 There are also challenges to using information alone to improve trust and confidence,[40] and to correct a poorly functioning market. We know simply giving people information does not necessarily change behaviour. In the past, the Department issued Automatic Pension Forecasts to enable people to make informed choices and plans. Evaluation showed this had little impact on pensions knowledge or the likelihood of people taking action to plan and save.[41] We also know that sending people too much information, or badly presented information, can do more harm than good.[42]

2.23 It is important to consider what behaviour greater disclosure may drive. Making all charges more transparent for members, including the unavoidable hidden charges such as trading costs, could lead to a greater detriment. Individuals' choices are limited by the fact that their employer chooses their scheme, so their only choice may be to opt out to avoid the higher charge. This could be far more detrimental than paying a high charge because they would lose their employer's contribution.

2.24 If employers do look at the information on charges sent by pension providers, there is little evidence to suggest that it will affect the way most behave. Instead, there is reason to believe that the benefits of greater disclosure will be moderated, to a large extent, by the wider incentive problems in the market. If employers are primarily motivated by the cost and ease of implementing a pension scheme, information which makes it easier to understand and compare the charges across schemes is likely to have only a marginal impact on their decision.

2.25 NAPF research[43] found that the majority of micro employers[44] (which make up the majority of employers, and those most at risk of high pension scheme charges) struggled to comprehend the information set out in the prototype guide they were provided. For employers who have difficulty comparing and understanding the impact of percentage-based charges, an information-based approach is likely to have little effect.

## Market failures

2.26 The OFT concluded that competition alone cannot be relied upon to drive value for money for all savers in the DC pension market and described the buyer side as one of the weakest they had analysed in recent years.[45] This is due to lack of demand from both individuals and their employers, and the complexity of the product.

[40] Vickerstaff *et al.,* 2012, *Trust and confidence in pensions*, Working Paper 108, Crown.
[41] Bunt and Barlow, 2007, *Evaluation of Automatic State Pension Forecasts*, Research Report No 447, Department for Work and Pensions.
[42] Better Regulation Executive, 2007, *Warning Too Much Information Can Harm, BERR; and The Futures Company, 2011, Automatic enrolment – information for workers qualitative research*, DWP Communications.
[43] B&CE & NAPF, 2012, *Telling Employers about DC Pension Charges: Research*, NAPF.
[44] Micro schemes are those with between two and eleven members.
[45] Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p16.

## Lack of demand and understanding amongst employees

2.27 Twelve million people are not saving enough and face an inadequate income in retirement.[46] Behavioural economics provides two main reasons for this: individuals tend to be short-sighted, preferring to spend today rather than save for tomorrow and, in the face of a complex long-term financial decision, individuals are inert and choose to do nothing rather than risk making a poor decision.[47] Automatic enrolment addresses myopia, but creates a large number of pension scheme members with low understanding of pensions and pension charging.

2.28 This widespread myopia around financial matters results in insufficient pressure on providers to offer competitive charges. In markets where there is weak demand, participants may end up competing on product features other than price; in the pensions industry, for example, providers often cite scheme communications as a key feature that may justify higher charges.

2.29 The available evidence implies that the general public's understanding of pensions and financial matters especially is low, with recent DWP research finding that around two-thirds of people consider pensions so complicated that they struggle to understand the best thing to do.[48] One reason that pension charges are difficult to understand is the effect of compounding charges.[49]

2.30 This lack of engagement in pensions means that the majority of employees are unlikely to be willing or capable to put pressure on their employer to drive down prices in the market.

## Lack of demand and understanding amongst employers

2.31 Automatic enrolment was introduced to address this lack of demand from employees by mandating that employers automatically enrol all eligible workers in a workplace pension scheme.

2.32 However, automatic enrolment does not correct all of the demand-side failures. In other, well-functioning markets, the ultimate beneficiary of the product is responsible for its selection. In automatic enrolment, the arrangements represent a clear example of a principal–agent problem, with all the potential difficulties in motivating the employer (the agent) to act on the best interests of the employee or end consumer (the principal) rather than their own.

2.33 We know that the key factor in scheme choice for many employers is likely to be a preference for a simple solution that is easy to implement, especially among employers new to pensions.[50]

2.34 As outlined by the OFT, when selecting a scheme, employers will be driven by factors beyond the price to members. Different employers may also consider the extent of support available from the provider and any direct costs of setting up the arrangement.

46 Department for Work and Pensions, 2013, *Framework for the analysis of future pension incomes*, Department for Work and Pensions.
47 DWP, 2006, *Personal accounts: a new way to save*, Department for Work and Pensions, p12.
48 MacLeod *et al.*, 2012, *Attitudes to Pensions: The 2012 survey*, Department for Work and Pensions Research Report No 813, Department for Work and Pensions.
49 Pitt-Watson and Mann H, *Seeing through British Pensions*, RSA, July 2012.
50 Wood *et al.*, 2010, *Likely treatment of different types of worker under the workplace pension reforms: Qualitative research with employers*, Department for Work and Pensions Research Report No 662, Department for Work and Pensions.

2.35 The risk of misaligned incentives may also increase as the size of the employer declines. Research by the NAPF and Building and Civil Engineers Benefit Schemes (B&CE)[51] found that while many employers were motivated by keeping staff happy, and smaller employers were often the most concerned about the welfare of their employees, the very smallest employers tended to be most concerned with survival and, as such, minimising the costs of automatic enrolment to them as an employer was of key importance.

2.36 This is supported by findings by The Pensions Regulator from their research with intermediaries involved in pensions, the majority of whom believed that cost to employers would be the main consideration when selecting a scheme. This was the factor mentioned most often by all types of intermediary, ranging from 43 per cent of pension consultants to 57 per cent of Human Resources (HR) professionals. In contrast, only 8 to 12 per cent cited cost to the employee as the main factor.[52]

2.37 Moreover, of those employers who already have provision in place, many simply do not know what charges their members pay. The 2012 DWP Charges Survey found that only around a third of employers were aware that members paid any charges at all.[53] This lack of basic knowledge among employers who have gone to the effort to put in place provision raises further concerns about the ability of employers unfamiliar with pensions to adequately consider charges when selecting a scheme and to recognise and negotiate a good deal.

2.38 While many employers are actively engaged and see pensions as a critical employee benefit and retention tool, we know that automatic enrolment will result in many employers offering their employees a pension for the first time. Only three in ten private sector organisations (31 per cent) made some form of pension provision for their employees in 2011 – and if one excludes contributions to employees' personal pensions, then only around a quarter (24 per cent) of all private sector firms provided a workplace scheme.[54]

### Lack of switching among employers

2.39 Widespread inertia means that many employers will simply stay with their existing pension scheme, rather than shopping around to help drive competition. DWP's 2011 *Employer Pensions Provision Survey* reported that 60 per cent of those who already offer workplace pension provision[55] planned to keep all current members in their scheme, and 49 per cent planned to use the existing scheme for non-members and new employees.[56]

2.40 While new schemes may offer more competitive charges, particularly to larger, profitable employers, the OFT have raised concerns about people being enrolled into high-charging legacy schemes (pre 2001), which have charges that are on average 26 per cent higher.[57] They are concerned that many members are stuck in, or risk being enrolled into, older schemes with higher charges because their employers or trustees do not regularly switch schemes or use the threat of switching to negotiate terms. The OFT suggest that those using smaller schemes are less likely to switch (and again the Department's research shows these are more likely to have higher charges).

51 NAPF, 2012, *Telling Employers about DC Pension Charges: Research*, NAPF.
52 The Pensions Regulator, 2012, *Intermediaries' awareness, understanding, and activity relating to workplace pension reforms*, BMG research.
53 Wood *et al.*, 2012, *Pension landscape and charging: Quantitative and qualitative research with employers and pension providers*, RR804, Department for Work and Pensions.
54 Department for Work and Pensions, 2011, *Employer Pensions Provision Survey, Department for Work and Pensions*, Report 802.
55 In which at least some employees are participating.
56 Department for Work and Pensions, 2011, *Employer Pensions Provision Survey*, Department for Work and Pensions, Report 802, p8.
57 Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p20.

2.41 The time and money required to switch schemes is one barrier that may prevent employers from taking action. Furthermore, following the ban on commission brought in by the RDR, there is now less incentive for advisers to recommend switching. This is because they will no longer be able to charge commission on any new scheme[58].

2.42 There has been some speculation that a 'fire sale' took place prior to RDR, to enable commissions to be incorporated into schemes used for automatic enrolment. If this were the case it would be of significant concern, given the reduced incentive this would create for future switching.

### How size affects an employer's ability to drive competition

2.43 Initial indications are that the very largest employers with the most profitable workforces are negotiating low rates for their employees. The ABI found charges for individuals in schemes newly set up for automatic enrolment to be just 0.52 per cent. This is similar to the charges found in the largest schemes in the DWP charges survey.

2.44 There has been some suggestion that the market is using loss-leading to capture profitable employers; in any case it is unlikely that trends to date provide a good indication of the deals available to SMEs.

2.45 The DWP charges survey found size was the greatest determinant of charge levels. Employers with smaller trust-based schemes of 12 to 99 members reported an average charge level of 0.82 per cent of funds under management, whereas schemes with 1,000 or more members had an average of less than 0.5 per cent of funds under management.[59]

2.46 When setting charges, providers typically look to ensure that each individual employer is profitable over a set payback period, so that all business taken on is sustainable. Fundamentally there may be little difference in the product offered, however, smaller employers are more likely to be offered a higher charge level, particularly if their staff have low salaries and levels of persistency, and therefore lower contribution levels.

2.47 The OFT found charges are driven to some extent by the size and growth of assets under management, which in turn depend on employer and member characteristics. However, they also consider that the variation in headline charge levels is unlikely to be driven purely by these factors and that differences are also driven by the ability of the employer to negotiate a reasonable charge.[60]

2.48 However, there have been a number of entrants to the market targeting a broad base of employers under automatic enrolment, where employees are charged a single set price regardless of their employer's characteristics. Some of these schemes have introduced business models which seek to ensure pricing is sustainable in the long term across each individual member rather than across employers.

[58] Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p75.
[59] Wood *et al.*, 2013, *Pension Landscape and Charging: Quantitative and qualitative research with employers and pension providers*, Crown.
[60] Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p114.

## Summary

2.49 It is apparent that there are some fundamental problems with the effectiveness of competition in the workplace pensions market and it is not clear that better information to either employers or individuals would alone be effective in addressing these problems and mitigating risks to individuals.

2.50 At present, many people are enrolled into schemes selected by employers, unaware of the level of scheme charges and their impact on retirement income. The complexity of charges makes comparison between schemes difficult. There is a risk that without further intervention a significant number of individuals may be enrolled into schemes which have higher charges, resulting in a much lower income in retirement than they otherwise could expect.

2.51 Charges in new schemes appear to be falling at the moment, but there is no guarantee that this will continue as less profitable smaller employers and their employees are brought into automatic enrolment in the coming years. There is also little evidence that providers are lowering charges in older schemes that are being used for automatic enrolment. To date only a handful of providers have responded to a challenge set in 2012 to review charges in legacy schemes and to commit not to use schemes charging more than 1 per cent of funds under management.

2.52 As automatic enrolment is extended to SMEs, it is vital that they are clear about the sorts of charging levels that represent reasonable value for their employees as they consider putting in place a qualifying scheme.

# Options for resolving market failures

# 3

3.1 The OFT set out a number of structural weaknesses in the pensions market which impact on the effectiveness of competition and therefore the increasing risk of individuals suffering detriment.[61] We welcome the OFT's report and the contribution it makes to our understanding of the workplace pension market; we agree that action must be taken to address the issues they have identified.

3.2 This chapter sets out options for tackling these issues to ensure both employers and individuals can have trust and confidence in their retirement savings.

3.3 This consultation covers a range of options, from proposals to improve transparency and disclosure in the market to more direct measures to directly limit charges on default funds in DC qualifying schemes. These proposals cover the following areas:

a) **Mandating disclosure for members** to ensure a consistent approach across providers and schemes, and to improve the coverage to include all scheme members.

b) **Standardising disclosure for employers** to introduce a standard framework for the disclosure of costs, charges and the services provided both at the point of sale and on an ongoing basis.

c) **Introducing a cap on pension scheme charges** for all members, both active and deferred, of default funds in qualifying DC schemes for employers who stage from April 2014. And then extending this cap to capture all employers who have staged from October 2012 up to and including March 2014, by April 2015.

[61] Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p16.

d) **Banning differential charging between active and deferred members**, both in terms of addressing AMDs and to deal with the practice where scheme members are moved into an individual personal pension with higher charges when they leave employment and stop making contributions. If introduced, this ban could apply to all schemes put in place for employers staging from April 2014. We are interested in whether transitional arrangements are needed to deal with schemes put in place prior to this date.

3.4 We are interested in receiving views on the extent to which these different approaches to tackling the issue of pension charges will address the market failures identified by the OFT.

## Options to improve disclosure

3.5 As the OFT have described, information can support the functioning of markets, for example, when scheme members are incentivised to make well-informed choices by demanding products from firms that are best able to meet their needs.

3.6 The OFT set out specific concerns regarding the insufficient visibility and comparability of pension charges to employers. In 2011, DWP published guidance on default funds for automatic enrolment schemes that specified a clear breakdown of charges should be provided, illustrating the likely effect of these charges on final retirement outcomes.

3.7 The OFT recommended that all costs and charges associated with pension schemes, including those associated with investment management, should be disclosed in a framework that will allow employers to compare a commonly defined single charge.[62]

3.8 As a first step it is vital that the industry moves to ensure charges are fully disclosed in a consistent, comparable and meaningful way to employers, when they are selecting a scheme, and in an ongoing way, to members. Enforcing a single number disclosure could facilitate comparison between different schemes and could help facilitate competition in the market by giving employers the information they need to make a choice about which scheme they use.

3.9 There are a number of actions DWP could take to improve disclosure to either employers or individuals. We will be exploring the following options as part of this consultation:

### Mandating disclosure to members

3.10 There are currently limited requirements on schemes to disclose the charges they impose on members, and the requirements that do exist vary by whether a scheme is contract or trust-based. In particular:

- **Contract-based schemes**: There are some limited requirements for stakeholder pension products, while contract-based schemes are required by the Financial Conduct Authority (FCA) to provide illustrations to members that show the effect of charges.
- **Trust-based schemes**: There is no requirement on trust-based schemes to disclose charges, and whilst all money purchase schemes are required by law to provide annual statements to members, there is no requirement to show information about charges on this.

3.11 Under Section 113 of the Pensions Scheme Act 1993, we could widen the disclosure requirements placed on trustees, providers and scheme managers to require consistent disclosure of costs and charges. We could prescribe for information about charges to be disclosed to members in the basic scheme information provided to new and prospective members on joining, and on the annual statement.

[62] Master trusts that levy other charges, in addition to an AMC, should provide employers with an equivalent comparable single figure.

3.12 This step would ensure that all scheme members receive consistent and standardised information on the charges they will, and have, incurred, which we know may help to improve trust and confidence in pension saving.

3.13 In terms of coverage, this is likely to have little additional benefit to the vast majority of members of contract-based schemes in light of the ABI's disclosure initiative. A number of large multi-employer trust-based schemes are also committed to disclosing charges in this way. It would, however, broaden coverage to ensure that members of all trust-based schemes received regular information on the charges paid.

3.14 A key issue to consider would be the extent of costs and charges to be included in the disclosure: currently the industry is committed to disclosing all charges excluding transaction costs and we will be considering whether further disclosure of transaction costs may be helpful.

### Standardising disclosure to employers

3.15 DWP has not put in place any requirements on providers or schemes to disclose information on charges at the point of sale to employers. Given its criticality in terms of decision making, however, it is generally included within pre-sale information.

3.16 In light of the OFT's findings on the comparability of charges, and wider concerns around gaps in pre-sale information, there is scope to consider whether further action could be taken to improve disclosure. There are two options that could be considered, either as standalone options or in conjunction:

- **DWP could publish its own code of conduct on the disclosure of charges to employers**.

  This would specify a standardised framework for the disclosure of costs and charges to be provided to employers at the point of sale.

  This could build on the initiatives already undertaken by the industry to improve disclosure by setting out the range of costs and charges that might be levied, as well as the services received.

  A code of conduct would not be statutory and therefore would not be binding.

- **Mandating disclosure to employers and specifying a standardised format** for this disclosure in regulations under Section 113 of the Pensions Act 1993.

  Again this would specify a standardised framework for the disclosure of costs and charges to be provided to employers from scheme managers and providers, on an ongoing basis once a scheme was up and running.

  The information could then be used by employers to consider whether their scheme continues to offer value for money and to enable comparisons to be made to inform decisions about whether a switch of provider might be appropriate.

### Disclosure of transaction costs

3.17 The Government has made clear that it would like to see improved standardised disclosure of transaction costs by the fund management industry to its customers – whether pension schemes or other types of investor. In this consultation we will consider whether it would be useful for this information to be disclosed to DC pension scheme members and employers, or limited to the schemes trustees or governance committees acting on their behalf.

3.18 The pensions' supply chain is frequently both complex and long, with members' funds or contributions subject to reduction at many points. It is at the level of the investment product that the greatest challenge lies in understanding what costs and charges members' funds are subject to, and whether such costs and charges are reasonable in relation to the value that the activity generates for the member.

3.19 The OFT examined the issue of transaction costs suggesting these should not be included in the single charge framework for disclosure to members and employers.

3.20 The OFT agreed with the ABI and its members that Independent Governance Committees should be set up to be embedded in all providers of contract-based and bundled trust-based schemes. The OFT's view was that transaction costs should be disclosed to these committees. As such, these committees and trustee boards in trust-based schemes could review these costs as part of their remit to consider all the key elements of value for money for schemes.

### Public comparison of charges

3.21 We are also considering whether there is a role for greater publication of charges to support comparison and decision making, for example, whether a regulatory body should publish a comparison table of charges, updated on a regular basis.

3.22 This would facilitate easy comparison for employers supporting decisions they make in respect of setting up and maintaining their schemes. It could also be useful to scheme members, helping to facilitate decision making around automatic transfers.

**Consultation questions**

2. **Is further action required by the Government to improve disclosure and if so which of the options should be introduced? Are there any other options?**
3. **How might the total cost of scheme membership including transaction costs be captured, what would be reasonable and practical to ask providers and investment managers to report on and to whom (members, employers and governance committees/ trustee boards)?**

## Options for a charge cap

3.23 The main objective of a cap would be to protect people in the default funds of DC schemes, who have not made active decisions about their pension saving, from extremes in terms of the level of charge they face. A critical question, therefore, is what constitutes the upper acceptable limit for an individual automatically enrolled into a new scheme.

3.24 There are risks to a cap – set too high and it could result in providers increasing charges to the level of the cap – set too low and it could lead to reduced choice in the market for employers or reductions in the quality of schemes. Any charge cap would need to balance the potential for either set of risks to be realised.

3.25 In light of the specific challenges faced by SMEs, any cap would need to be implemented by April 2014. If a cap were implemented, it could be applied to all members of DC default funds at a later date.

3.26 In light of the available evidence our view is that very few employers who stage prior to April 2014 would be required to revise their provision in light of the extension of the cap. However, we would want to provide sufficient time for any changes that are required to be put in place and would propose extending the cap for employers staging between October 2012 and March 2014 from April 2015.

3.27 We know that the employers responsible for selecting a suitable default fund will need to be able to clearly identify that their scheme meets the criteria to be a qualifying scheme. Any cap must be sufficiently flexible to capture different structures of charge, while placing limitations on the level.

3.28 We propose that a series of charge structures for use within qualifying schemes would be set, with limits on the acceptable charge level of each structure or indeed its component parts. Whatever the charging structure, individuals could be assured that they would experience broadly equivalent charges across different structures over the lifetime of their saving.

3.29 The structures would be:

- A percentage of funds under management.
- A combination of a percentage of funds under management with a limited contribution charge.
- A combination charge of a percentage of funds under management and a limited flat fee.

3.30 In setting the level of the cap for structures which are not a pure AMC, we would look to ensure that the level set for these structures delivers broadly equivalent or better outcomes than under a pure, 'funds under management charge' for the majority of members over the longer run.

3.31 In light of the fact that the majority of schemes utilise a funds under management structure, we will focus discussion of the level of the cap in these terms, but would welcome views on an appropriate cap level for the alternative structures.

3.32 We would value feedback on the following options for setting the level of a cap. It is possible that any final cap could lie somewhere between the two levels suggested, depending on the evidence received.

- **Option 1: A higher charge cap of 1 per cent of funds under management**, reflecting the current stakeholder pension cap for certain scheme members.[63]
- **Option 2: A lower charge cap of 0.75 per cent of funds under management**, reflecting the charging levels already being achieved by many schemes.
- **Option 3: A two-tier 'comply or explain' cap**. There would be a standard cap of 0.75 per cent of funds under management for all qualifying schemes. A higher cap of 1 per cent would be available to employers who reported to the Pensions Regulator why the scheme charges in excess of 0.75 per cent.

In particular, employers, with the support of providers, would be expected to satisfy a series of conditions in respect of scheme quality to ensure this higher charge level delivered a benefit to members. A higher cap would not be available for combination charging structures.

[63] For new members from 6 April 2005, the charge cap is 1.5 per cent per annum, reducing to 1 per cent after 10 years of continuous membership in the scheme.

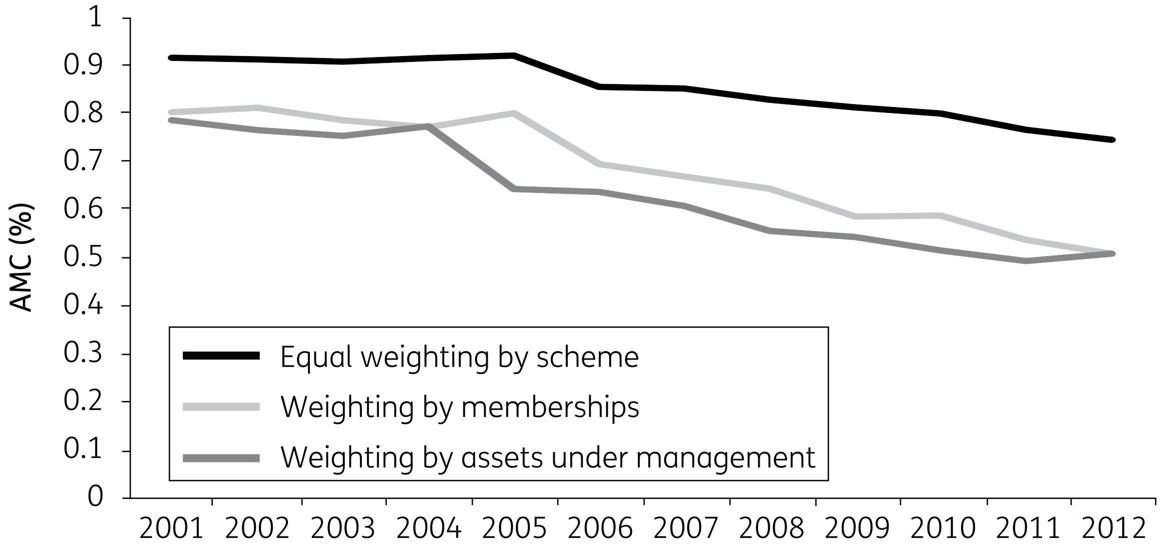
3.33 Under all options, we anticipate that employers would need to pass details of their schemes charges, received from their provider, onto the Pensions Regulator at the point of scheme registration to ensure compliance. Providers and scheme managers may then be required to provide information on charges to the Pensions Regulator on an ongoing basis.

### Option 1: 1 per cent cap on default funds in DC qualifying schemes

3.34 Stakeholder pensions were initially introduced in 2001 with a charge cap of 1 per cent of funds under management. As such this has existed as a benchmark in the industry for some time and, at present, DWP research shows that over 30 per cent of both trust and contract-based schemes charge at this level, while a minority (10 per cent of contract-based and 6 per cent of trust-based) are charging above this amount.

3.35 However, there has been a steady fall in the level of charges for new schemes put in place since 2001. The OFT[64] found a number of factors underpinning this fall, including improvements in administration and an increase in assets under management as a result of employers 'switching schemes'.

**Figure 5: Average AMC on schemes set up by contract-based and bundled trust-based pension providers in each year**




Source: OFT, based on data submitted by providers
Note: This figure shows the AMC at 1 January 2013 for schemes that were set up in each calendar year

3.36 It is questionable whether 1 per cent still reflects a reasonable ceiling for what individuals should expect to pay in charges. A number of multi-employer schemes have entered the market with charges at or around the level of 0.5 per cent of funds under management or equivalent. Some have argued that charges above this level for default funds cannot be justified.

3.37 A higher cap might lead to providers increasing their charges to the level of the cap. However, to some extent the entrance of large multi-employer schemes, charging at a level equivalent to a 0.5 per cent of funds under management, is providing a lower benchmark for the industry which offsets this risk.

[64] Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p101.

### Option 2: 0.75 per cent cap on default funds in DC qualifying schemes

3.38 A cap set at a level of 0.75 per cent would present a lower ceiling, and would require a greater proportion of employers to review their existing provision in order to comply with this requirement. However, it could provide benefit to a significant proportion of people by significantly reducing the charges they would otherwise be paying.

3.39 From the evidence available, it is clear that a significant portion of new business now sold is charged well below one per cent. The data collected by the OFT and set out in Figure 5 indicates a lower benchmark for new business. The ABI have also found that average customers in schemes set up for automatic enrolment faced an AMC of 0.52 per cent, while those in pre-existing group personal pension (GPP) schemes faced an AMC of 0.77 per cent.

3.40 In February 2013, NAPF reduced the level a scheme can charge for its default fund in order to receive its Pension Quality Mark from 1 per cent to 0.75 per cent.

3.41 A more stringent cap could lead to risks of reductions in quality or stifle innovation in terms of product development. Some stakeholders have suggested that higher charges reflect higher quality schemes in particular, in the form of greater investment returns or reduced volatility of returns.

3.42 In respect of higher returns, whilst this may be the case in some instances, the Department has not seen evidence showing that this is generally the case, whilst some have argued that it is not – and that small number of specialist fund managers who deliver above-average performance are unlikely to be managing the assets of employees with lower and median incomes, who are the target market for automatic enrolment.[65]

3.43 Automatic enrolment will, in time, improve retirement outcomes across a mass market group who are under-saving significantly. The mass market nature of this group means it is unlikely that above average investment returns could be achieved across all the default funds aimed at this group. As the OFT found, it may also be difficult for all employers to make an informed decision about how higher charges reflect greater scheme quality, given that investment performance can only be assessed over the long run.

3.44 What is clear, however, is that a lower cap could lead to a greater level of disruption to the industry, particularly in light of the number of schemes currently charging at or just below 1 per cent. Moreover, it could impact on advisers, depending on how providers of schemes with commissions seek to manage down their costs.

3.45 It could also have a greater impact on the number of employers who intend to use pre-existing pension provision to fulfil their employer duties. Evidence from the DWP charges survey suggests that setting the cap at 1 per cent could be expected to affect relatively few employers. In contrast, given the large proportion of existing schemes charging in excess of 0.75 per cent,[66] significantly more employers intending to use their existing scheme are likely to have to review or renegotiate this provision if a cap were set at 0.75 per cent rather than 1 per cent.

[65] Harrison D, Blake D and Dowd K, Caveat Venditor, *Pensions Institute*, October 2012. An older report by the Pensions Institute in 2000 concluded that there was "no support, either in theory or on the basis of existing evidence, for the argument that high charges can be justified by the promise of the superior investment performance that such high charges might be able to purchase." And in 2002, the Sandler Review concluded that "charges for near identical products can differ widely".

[66] Wood *et al.*, 2013, *Pension Landscape and Charging: Quantitative and qualitative research with employers and pension providers*, Crown.

### Option 3: Comply or explain

3.46 To address the risk that good quality, but higher-charging, schemes are precluded from being used for automatic enrolment, an alternative option to one single cap would be to introduce a two-tier 'comply or explain' cap. This would ensure a lower benchmark for the majority of schemes, in keeping with the levels of charge currently on offer in the market, but enabling some flexibility for those schemes where enhanced features are on offer, to charge a higher amount.

3.47 This approach would only be available to employers with schemes only levying charges as a percentage of funds under management. The purpose would be to enable greater flexibility to be retained in respect of charging, where value to members could be clearly demonstrated.

3.48 Under this option, any employers wishing to put in place a scheme with a charge between 0.75 per cent and 1 per cent would be required to provide evidence justifying the higher charge level to the Pensions Regulator at the point of registration. Specific conditions could be outlined in regulations indicating the acceptable quality features which would justify a higher charge to enable the Pensions Regulator to monitor compliance.

3.49 A 'comply or explain' approach may offset some of the risks associated with a cap. It would enable innovation for better quality features that could be funded through higher charges while offsetting the risk of providers offering schemes at higher charge levels without a strong justification in terms of the quality of the product on offer.

3.50 The need to reflect some variations in scheme quality has been raised by some in the industry to ensure that account can be taken of factors driving better member outcomes. The level of governance in place to protect members, the extent to which the volatility of risk may be managed to align with members' preferences, and the levels of member communications aimed at reducing opt out are often cited as aspects of scheme quality which may deliver benefits.

3.51 We would be interested in receiving views on the following issues:

**Consultation questions**

4. **Do the proposed implementation dates for a cap provide sufficient time for employers to review and put in place compliant arrangements? The dates are:**
   - **April 2014, for all employers staging from April 2014 onwards.**
   - **April 2015, for all employers who staged between October 2012 and March 2014.**
5. **Which of the three options for a cap is the most appropriate?**
6. **Under option 3, what conditions would you expect for schemes levying a higher charge between 0.75 per cent and 1 per cent?**
7. **How will employers and pension providers respond to a cap on charges and what evidence is there that charges will be 'levelled-up' in response to a cap?**
8. **What evidence is there on the link between scheme charges and scheme quality or investment returns?**
9. **If a cap is introduced, what if any changes should the Government consider in respect of the stakeholder charge cap?**
10. **Are there any alternative options to capping charges that would provide protection for scheme members?**

## Quality standards for work-based pension schemes

3.52 The Government wants all workplace defined contribution schemes – whether contract based or trust based – to deliver some legislative minimum quality standards. The Pensions Bill 2013–14 includes powers to set these standards, including to limit or prohibit charges in these schemes.

3.53 We ran a call for evidence from 4 July to 9 September to inform the development of the minimum standards. As work on these standards is developed we will consider how these align with any action on charges on default funds in qualifying schemes.

## Solvency requirements

3.54 Discussions with the Prudential Regulation Authority (PRA) have highlighted the fact that introducing a charge cap would have implications for the level of capital insurers are required to hold in order to protect customers against the risk of insolvency.

3.55 The risks to an insurer's solvency posed by a cap are two-fold: firstly there is a risk that if expenses rise far enough then the lack of an ability to pass these on to scheme members by raising the product's price may adversely affect the insurer's solvency; secondly, where the charge is levied on assets under management, its absolute level will vary depending on the performance of the underlying assets and there is a risk that it may not cover expenses. In order to protect against these risks, insurers would have to hold additional capital against the funds covered by the charge cap. This additional capital would come from the insurance company's shareholders and would therefore have a cost, which would be the difference between the expected return on shareholder capital and the yield on risk-free assets (since this is what the additional capital would be held in).

3.56 This cost is highly uncertain for a number of reasons: (i) expected return on shareholder capital will vary by company; (ii) the risk-free yield will vary according to conditions in the market for high-quality, government bonds; (iii) the additional capital required will depend on the amount of assets covered by the cap.

3.57 Our current assessment is that the additional impacts on capital will be relatively small. This is because the policy intention is to apply the cap for schemes that are being used for automatic enrolment. The impact for brand new schemes will therefore be negligible in the short to medium term because assets under management will take time to build up, particularly in light of the profile of employers due to stage from April 2014. The majority of the effect will come from older schemes that are being made compliant with the cap and being used to write new business – it is not certain how many of these schemes exist.

3.58 In the event that a significant shock impacted on insurance providers of the magnitude that would affect their collective solvency, DWP could make regulations as soon as possible to raise the level of the charge cap.

3.59 Depending upon the level at which the cap is set, this issue may not 'bite' on providers at all, for example a 1 per cent cap may provide sufficient spare capacity for providers to raise prices in the event of a significant shock such that they could mitigate any solvency risks.

**Consultation questions**

**11. What impact will a charge cap have on the capital reserves pension providers need to hold under:**

- **A 0.75 per cent or equivalent cap?**
- **A 1 per cent or equivalent cap?**

## Definition of charges

3.60 We propose specifying a broad, all encompassing definition of the different charging elements to mitigate against avoidance risk and 'innovation in charging' to elude a cap. This will enable employers to have confidence in the comparisons they make across different pension providers when selecting a pension scheme for their employees. Once we have received responses to the consultation, any evidence on the range of charges and costs that may be levied, we will need to ensure that we have sufficient powers to make the relevant regulations.

3.61 To date we have heard divergent views on whether transaction costs should be included within a cap. On the one hand some argue that it would mitigate against the risk that additional charges could be hidden as a means of circumventing the cap. On the other, some argue that by capping trading costs you could prevent trades occurring that are in the interests of members.

3.62 The issue of ensuring that trading costs remain in proportion and of value to members links very closely with the question of governance. This was raised by the OFT in its report, as well as in our call for evidence on scheme quality, which we will report back on later this year.

**Consultation questions**

**12. Should transaction costs be included within a charge cap?**

**13. Would requiring the disclosure of transaction costs to trustees and the independent governance committees to be set up for contract-based schemes help to manage any potential avoidance risks associated with a charge cap?**

**14. Are there any specific services that may need to be excluded from the cap to avoid constraining innovation, for example, in respect of annuity broking services?**

## Active Member Discounts

3.63 The latest DWP charges survey found a minority of schemes report the use of AMDs. However, providers have reported that they are becoming increasingly popular, and some of the very large providers had sold the majority of their GPP schemes with an AMD in the 12 months prior to the research.[67] The average percentage point discount applied to the AMC was found to be 0.45 to 0.55 per cent.

3.64 The OFT study supports these findings, reporting that 7 out of 13 major providers use AMDs and that approximately 15 per cent of post 2001 contract-based schemes have AMDs. The OFT estimates that there are currently around 9,800 contract based schemes containing around £13.4 billion of assets with AMDs. In these schemes, the AMC is on average 0.47 percentage points higher for deferred members than for those still actively contributing. The highest reported AMD is 1 percentage point.[68]

[67] http://research.dwp.gov.uk/asd/asd5/rports2011-2012/rrep804.pdf
[68] Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p105.

3.65 We have also heard that some providers export deferred members from GPPs to individual pensions, which may have higher charges. This is not referred to as an AMD, but the effect is the same. We have limited information about how this change in charge level is communicated to the employer or scheme members.

3.66 Today's workforce is highly transient – the average person moves jobs 11 times during their working life.[69] That is why the Government is bringing forward reforms in the current Pensions Bill to enable people's pots to be automatically transferred as they move jobs.

3.67 However, this transience implies that the prevalence of AMDs could result in a significant proportion of savers paying higher charges. Which? suggested, in their evidence to the WPSC, that the likelihood of scheme members becoming deferred members are high because they have found that around 60 per cent of people who start contributing to GPPs have stopped contributing after four years (mainly due to job changes). Which? calculates that these increased charges for deferred members could potentially reduce pension income by around 25 per cent.[70]

3.68 In an automatic enrolment world where people are placed into a scheme without making an active choice and where there is no overriding body responsible for considering the interests of deferred members, this is a cause for concern.

3.69 The OFT expressed concerns about the use of this form of charging and recommended that they should be banned. In addition, employees who are converted into an individual personal pension, instead of being classified as deferred members of a scheme, should also not be penalised in respect of the charges they pay.[71]

3.70 The WPSC have also said that they 'did not hear any convincing evidence for retaining these charges and recommend that the Government bans the use of AMDs without delay, in order to prevent scheme member detriment arising from this practice'.[72]

3.71 We therefore propose to include deferred members if a charge cap is introduced from April 2014 to ensure deferred members in qualifying schemes are no worse off than those members in schemes with charges at the level of the cap. We will also consult on banning AMDs.

3.72 We are interested in hearing views on whether differential charging on the basis of whether a member is active or deferred should be banned, the potential consequences of this, and any necessary transitional arrangements.

**Consultation questions**

**15. What would the impact be of a ban on Active Member discounts and other arrangements where deferred members pay an increased charge in qualifying schemes, would providers need to increase charges for active members and if so, by how many percentage points?**

**16. What, if any, transitional arrangements might be needed for those schemes already set up?**

**17. Can you provide more information about the scenario whereby employees who leave their job are converted into an individual personal pension? Does this require the member's consent and is this practice disclosed to employers when they choose the scheme?**

69 Johnson P, Yendle D and Boulding A, *Making Automatic Enrolment Work, A review for the Department for Work and Pensions*, October 2010, p172.
70 Which? evidence to WPSC. http://www.publications.parliament.uk/pa/cm201213/cmselect/cmworpen/768/768we30.htm
71 Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p28.
72 House of Commons Select Committee on Work and Pensions, *Improving governance and best practice in workplace pensions*, April 2013, p49.

# Consultancy charging and commission

4

## The Retail Distribution Review

4.1 On 1 January 2013, the RDR came into effect. Its principal aim is to give scheme members confidence that the advice they receive when buying a financial product is in their best interests. For instance, it ensures that advisers are not simply recommending the provider paying them the highest commission.

4.2 The RDR banned providers from paying commission to advisers on all new GPPs. Advisers now have to charge upfront fees for their services. Financial advice that may previously have appeared to be free is now clearly disclosed to individuals and employers.

4.3 Consultancy charges were introduced under the RDR to replace commission. They enable employers to pass on the pre-agreed cost of advice to their employees who join the pension scheme. Consultancy charges function either as a levy on contributions or as a charge on the fund, ultimately reducing the size of the members' pots.

### Consultancy charging

4.4 Consultancy charges were designed against the backdrop of a voluntary saving system, but they create perverse outcomes for an automatically enrolled population. This is because there is a misalignment between the interests of the primary consumer (the employer) and the end customer (the member). The party that chooses the service and agrees the price is the employer, but the fee is ultimately paid by individual members.

4.5 As with other pension charges there is no one in this arrangement with sufficient incentive to drive down costs and ensure value for money. The member has only two options: to pay the consultancy charge out of their pension pot, or to opt out of pension saving and forgo the employer contribution.

4.6 DWP conducted a review of consultancy charging between November 2012 and May 2013. This found that existing measures to prevent advisers from deducting high charges from members' pension pots were inadequate. It also highlighted that consultancy charges were likely to have a disproportionately negative impact on people who move jobs regularly, because they might have to pay higher 'initial' scheme set-up charges following each move.

4.7 Additionally, the review found that consultancy charges were likely to be used to pay for employer compliance with automatic enrolment. This has been likened to expecting workers to pay for the steps that their employer takes to ensure compliance with health and safety law.

4.8 A broad consensus emerged during the review that, without additional protection, there was a significant risk of scheme member detriment with consultancy charges. This view was reinforced by the WPSC which, in April, raised concerns about the impact of consultancy charges on individuals' income in retirement. Following the committee's recommendations, in May 2013 the Government announced its decision to ban consultancy charges in automatic enrolment schemes.

### Existing regulations for consultancy charges in automatic enrolment schemes

4.9 On 14 September 2013, regulations came into force that introduced a new condition for automatic enrolment schemes providing money purchase benefits. These effectively specify that the scheme cannot allow an employer to make an agreement with a third party where that third party is to be paid from the members' pension pots, investment returns, or contributions.

4.10 These regulations do not affect the small number of schemes where there was a legally enforceable agreement in place between an employer and a third party before the Government announced its intention to regulate on 10 May.

## Current exclusions from the definition of third party

4.11 Trustees, scheme managers and providers were excluded from the definition of third party, because we did not want to interfere in the day-to-day running of pension schemes. We were confident that existing rules and regulations provided some protection: trustees have a fiduciary duty to act in the best interests of members, while providers must consider the interests of members under the FCA's 'Treating Customers Fairly' principle.

4.12 However, this exclusion means that vertically integrated firms, whereby a provider offers advice to employers, may be able to pass the cost of advice on to the member. Furthermore, a provider (either insurance provider or master trust) could outsource services to a third party and include the cost of the outsourcing in the product charges.

4.13 The current regulations also allow for schemes to agree to pay for blending funds, where an adviser is paid through a basis point charge for ‘blending’ a default fund together from a range of funds. On the limited evidence available, it appears that these charges are currently small. They should, however, be proportionate to the value provided and not used to cross subsidise other features.

## Proposal

4.14 The decision to ban consultancy charges received widespread support in Parliament, among consumer groups, and from the market.

4.15 However, it is important to protect all savers and not just those in automatic enrolment schemes. As such, the Pensions Bill 2013–14, currently before Parliament, contains measures to broaden the existing powers, enabling the ban on consultancy charging to be extended to all qualifying schemes.

4.16 However, it is important to protect all savers and not just those in automatic enrolment schemes. As such, the Pensions Bill currently before Parliament contains a clause which broadens the existing powers, enabling the ban on consultancy charging to be extended to all qualifying schemes.

4.17 This would mean that consultancy charges agreed before 10 May would have to stop for both new and existing members if the scheme is being used to comply with automatic enrolment duties. We are mindful, however, that these regulations could potentially cause some disruption to pension providers.

**Consultation questions**

18. **How are the existing regulations working in practice and how are services now being delivered and paid for?**
19. **How are charges for blended funds structured, their level set and what disclosure is in place for members and employers?**
20. **What impact would extending these regulations to qualifying schemes have on providers, employers, advisers and any other third parties, and what if any transitional arrangements would be appropriate?**

## Commission

4.18 Advisers can continue to receive commission for current and future members of schemes set up before the introduction of RDR in January 2013. There is some anecdotal evidence that there was a spike in sales of GPPs in the months leading up to the introduction of the RDR. If this spike in sales was a rush to set up schemes with commissions to be used for automatic enrolment, this would be a cause for concern.

4.19 The OFT is concerned that employees may be automatically enrolled into schemes that contain built-in adviser commissions. It is also concerned that commissions create a barrier to employers switching to a better value scheme, firstly because of the costs of selecting and managing the transition to a new provider, and secondly because of adviser conflict of interest in switching from a scheme with built in commissions to one without.

4.20 New employees may therefore be enrolled into an employer's existing scheme and pay commission (without necessarily benefiting), even if lower charging alternatives are available. For these reasons the OFT has recommended that schemes with built-in commissions should not be used for automatic enrolment.[73]

4.21 We are interested in receiving views on whether commission should be banned and any evidence on the potential impacts of this measure.

**Consultation questions**

**21. What would be the impact of a ban on commissions in qualifying schemes and does commission present a barrier to switching?**

**22. What evidence is there of an increase in sales of DC schemes with commission in 2012?**

**23. How much (on average) has commission on these schemes increased the AMC in percentage points?**

[73] Office of Fair Trading (OFT), 2013, *Defined contribution workplace pension market study*, OFT 1505, Crown, p93.

# How to respond 5

## Scope of consultation

5.1 This consultation applies to England, Wales and Scotland.

## Duration of the consultation

5.2 The consultation period begins on 30 October 2013 and runs until 28 November 2013.

5.3 Please ensure your response reaches us by that date as any replies received after this may not be taken into account.

5.4 The Government's new consultation principles were introduced on 17 July 2012. The new principles are at http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance

## How to respond to this consultation

5.5 Please send your consultation responses, preferably by e-mail, to: reinvigorating.pensions@dwp.gsi.gov.uk

Or, by post to:

Charges Team
Private Pensions Policy and Analysis
1st Floor, Caxton House
6-12 Tothill Street
London
SW1H 9NA

5.6 When responding, please state whether you are doing so as an individual, or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled. We will acknowledge your response.

5.7 We have sent this consultation document to a number of people and organisations who have expressed an interest in these issues. Please do share this document with, or tell us about, anyone you think will want to be involved in this consultation.

5.8 We will publish the responses to the consultation in a report on the consultations section of our website. The report will summarise the responses and the action we will take as a result.

## Queries about the content of this document

5.9 Please direct any queries about the subject matter of this consultation to the e-mail address given above.

## How we consult

### Freedom of information

5.10 The information you send us may need to be passed to colleagues within the Department for Work and Pensions, published in a summary of responses received and referred to in the published consultation report.

5.11 All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

5.12 To find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact:

Freedom of Information Team
Caxton House
6-12 Tothill Street
London
SW1H 9NA

Freedom-of-information-request@dwp.gsi.gov.uk

5.13 The Central Freedom of Information team cannot advise on specific consultation exercises, only on Freedom of Information issues. More information about the Freedom of Information Act can be found at www.dwp.gov.uk/freedom-of-information

### The consultation criteria

5.14 The consultation is being conducted in line with the new Cabinet Office consultation principles. The key principles are:

- departments will follow a range of timescales rather than defaulting to a 12-week period, particularly where extensive engagement has occurred before;
- departments will need to give more thought to how they engage with and consult with those who are affected;
- consultation should be 'digital by default', but other forms should be used where these are needed to reach the groups affected by a policy; and
- the principles of the compact between Government and the voluntary and community sector will continue to be respected

## Feedback on the consultation process

5.15 We value your feedback on how well we consult. If you have any comments on the process of this consultation (as opposed to the issues raised) please contact our Consultation Coordinator:

Elias Koufou
DWP Consultation Coordinator
2nd Floor, Caxton House
Tothill Street
London
SW1H 9NA

Phone 020 7449 7439

elias.koufou@dwp.gsi.gov.uk

5.16 In particular, please tell us if you feel that the consultation does not satisfy the consultation criteria. Please also make any suggestions as to how the process of consultation could be improved further.

5.17 If you have any requirements that we need to meet to enable you to comment, please let us know.

# List of consultation questions

### Transparency and disclosure

1. **We would welcome views and evidence on the effectiveness of these initiatives and the extent to which the industry discloses charges upfront, in a consistent manner, to members and employers.**
2. **Is further action required by the Government to improve disclosure and if so which of the options should be introduced? Are there any other options?**
3. **How might the total cost of scheme membership including transaction costs be captured, what would be reasonable and practical to ask providers and investment managers to report on and to whom (members, employers and governance committees/ trustee boards)?**

### Charge cap options

4. **Do the proposed implementation dates for a cap provide sufficient time for employers to review and put in place compliant arrangements? The dates are:**
   - **April 2014, for all employers staging from April 2014 onwards.**
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    - **A 1 per cent or equivalent cap?**
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17. **Can you provide more information about the scenario whereby employees who leave their job are converted into an individual personal pension? Does this require the member's consent and is this practice disclosed to employers when they choose the scheme?**

## Consultancy charges

18. **How are the existing regulations working in practice and how are services now being delivered and paid for?**
19. **How are charges for blended funds structured, their level set and what disclosure is in place for members and employers?**
20. **What impact would extending these regulations to qualifying schemes have on providers, employers, advisers and any other third parties, and what if any transitional arrangements would be appropriate?**

## Commissions

21. **What would be the impact of a ban on commissions in qualifying schemes and does commission present a barrier to switching?**
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