Department
for Work &
Pensions

Review of the Default Fund Charge Cap and Standardised Cost Disclosure

---

13 January 2021

Contents

Contents 2
Ministerial foreword 3
Executive summary 4
Background to the call for evidence 5
What we asked 6
Number of responses 6
Analysis of responses 7
1. Scope of the charge cap 7
1.1 Transaction costs 7
1.2 Life Insurance 11
Government response 11
2. Level of the charge cap 12
Government response 15
3. Use of combination charges 16
Government response 19
4. Standardised cost disclosure templates 20
Government response 24
Conclusion 25
Annex A – List of respondents 26

Ministerial foreword

This Review is one of a series of measures we are taking to help protect members from unfair charges and enable access to a more diverse range of investments that offer the potential for higher returns. My aim is to make it as easy as possible for pension savers to have access to comprehensive and transparent information on costs and charges and we will be exploring what more can be done by way of standardisation in 2021.

The Charge Cap on funds under management is an important consumer protection which since its introduction in 2015 has benefitted over 10 million pension scheme members. The 2017 Charges Review confirmed that it had helped drive down costs for members and ensured that they continued to receive value for money on their investments. The evidence from the Pension Charges Survey 2020 is that the Charge Cap at 0.75% remains the right level and for that reason I will not be making changes at this time.

One of my priorities is to protect individuals who are automatically enrolled into a qualifying, defined contribution pension scheme from high and unfair charges and from the risks of erosion to their pension savings from such fees. Whilst automatic enrolment has been a huge success, some people, particularly those on the lowest incomes, are changing jobs more frequently, with a resulting increase in the number of deferred small pension pots. I am committed to limiting the erosion of the value of small pots, where flat fee charges risk depleting deferred pots to zero. Nobody should be automatically enrolled, only to find their hard-earned pension savings significantly reduced by charges. Therefore, I will be introducing a minimum level initially set at £100, before a flat fee element of a charging structure can be applied to these pots. I will keep the amount of the minimum level under review with a view to raising it at some stage in the future. I will also take into account the recommendations from the Small Pots Working Group, who are considering broader action that can be taken to prevent small pot proliferation.

Finally, I remain committed to improving transparency and standardisation of costs disclosure information. Costs transparency initiative (CTI) templates were introduced in 2019 and the call for evidence showed support for improving disclosure and increasing uptake of the CTI templates. Given the importance of transparency for pension savers and in line with the Work and Pensions Select Committee recommendations[1], I will closely monitor the adoption of the CTI templates, and we will look to introduce legislation in the future should we not see satisfactory levels of voluntary take-up.

We believe this review provides a framework for future action and it should be seen as a significant step in ensuring that the consumer comes first.

[1] Work and Pensions Select Committee recommendations

Executive summary

The Government committed to undertake this review of the default fund charge cap and standardised cost disclosure by the end of 2020 following the last review of the charge cap in 2017. These were also recommendations in the Work and Pensions Select Committee 2019 report Pension Costs and Transparency[2]

We sought and have considered a wide range of views through a call for evidence which ran for 8 weeks and closed on 20 August 2020, as well as the findings from the Pension Charges Survey 2020, which gathered evidence broadly concurrently to the call for evidence.

Since the 2017 charges review, Automatic Enrolment has proved very successful with more than 10.3 million workers automatically enrolled into a workplace pension to date. This has led to the growth of master trusts and also the number of pension pots that need to be administered.

The responses we received to the call for evidence and the Pension Charges Survey 2020, tell us that the Defined Contribution (DC) market is working competitively and we are not seeing administration charge levels sitting close to the cap limit. Findings from the Pension Charges Survey 2020 found all members in the qualifying schemes covered by this research are now below the cap and the average charge of 0.48% across all members, is significantly below the cap.

The Government also acknowledges the concerns raised by respondents, particularly around the impact of market uncertainties from events such as Covid-19 and the importance of affording schemes the flexibility of using headroom to deal with these challenges. Therefore, we will not be changing the level of Charge Cap at the present time.

There was little support amongst respondents to bring transaction costs within the charge cap. Many responses referred to difficulty in predicting transaction costs, which could lead to a scheme that would otherwise operate within the charge cap, exceeding it. Others raised a concern that inclusion of transaction costs could limit headroom within the cap, which in turn may limit the opportunity for innovation and new types of investment which could add value to members' investments. Therefore, we have concluded that we will not include transaction costs within the charge cap at this time.

A significant concern amongst respondents is the implications of small pots for both members and scheme providers. For members with small pots, particularly those with deferred pots, there is a significant risk of erosion of pot value; principally where a scheme uses a flat fee charge. For scheme providers, the issue is around the disproportionality between the cost of administering the increasing number of small pots in comparison to the benefits generated.

[2] Work and Pensions Select Committee 2019 report Pension Costs and Transparency

Many respondents were in favour of the proposal to incorporate new conditions to the flat fee charge structure. However, there was strong support for addressing the wider issue of small pot proliferation.

Some industry respondents raised concerns about the implications of setting a de minimis, particularly on the financial sustainability of schemes providing services to lower earners as the market continues to mature.

The Government needs to strike a balance between protecting members, especially those with small pots, and maintaining the financial sustainability of scheme providers. We have concluded that it is right to set a de minimis pot size below which flat fees cannot be charged. Therefore, we propose to initially set a de minimis of £100 on each member. This is to be applied to the default funds of schemes used for automatic enrolment. Any pot up to this size would not have flat fee charges applied to it, however, percentage charges applicable as part of a combination charge could still be applied. If a member has multiple pots within the same scheme, the de minimis would apply across all the pots being charged. However, we would expect that schemes would look at consolidating these pots in the long term. The £100 level will be kept under review with a view to increasing the level in time.

Whilst this review has confirmed that the charge cap continues to work well, it has led to our proposal to set a de minimis for flat fee charges. However, there are further changes we intend to make on behalf of pension scheme members.

Our review showed there was support for a standardised cost reporting process to ensure transparency and consistency in the reporting of costs and charges to trustees. This will ensure trustees can compare costs and ensure they deliver value for money for their members. The CTI process has been in place since 2019 and take-up has continued since then, but is not yet universal. As value for money for members is a key priority, ensuring trustees have the right information available to them is essential. We will consider legislating on this matter in due course, if take-up is not sufficient.

Throughout the pensions industry, there is an inconsistency around the charges information available to scheme members and members of the public. There is a lack of clarity on what charges members face and how they are calculated. This can make assessing value for money of the charges they pay, more difficult. With this in mind, we will explore how better standardisation of charges and how they are expressed can be introduced.

Background to the call for evidence

The Government made a public commitment to undertake an examination of the cap that applies to member-borne administration charges in the default investment funds of DC pension schemes used for automatic enrolment by the end of 2020. This would include consideration of whether the level and scope of the charge cap, as well as permitted charging structures, should change.

To fulfil this commitment, the Department launched the Review of the Default Fund Charge Cap and Standardised Cost Disclosure Call for Evidence. All interested stakeholders were invited to submit comments and evidence over an 8-week period ending on 20 August 2020. In addition, we held roundtables and bilateral meetings with stakeholders on technical aspects of the policy options in the Call for Evidence.

Alongside the Call for Evidence, the Pension Charges Survey 2020 captured data from 20 providers which accounted for 29.3m pension pots, including the ten largest providers. However, the provider data covers less than 29.3m individuals, since some individuals will hold multiple pension pots with different providers. In addition, 35 qualifying unbundled schemes were interviewed, with 32 providing sufficiently complete data to be included in the analysis. These unbundled schemes accounted for 432,000 members.

What we asked

The call for evidence sought views on whether the level of the charge cap should be reduced; the extent to which transaction costs and other costs associated with life assurance products should be included in the cap; fees structures and in particular, how members with small pots subject to charging structures, which include a flat fee element, run the risk of their pots being eroded; and set out options for assessing existing take-up, and widening the use, of standardised cost disclosure templates when calculating and evaluating pension charges.

Respondents were asked for their views on 18 consultation questions, covering the following themes:

- level of the charge cap
- scope of the charge cap
- use of combination charges which include a flat fee charge
- use of standardised cost disclosure templates

Each of these areas is discussed in later chapters of this document.

Number of responses

We received 68 responses to the call for evidence from a broad range of respondents including pension scheme providers, insurance providers, professional industry bodies, third party providers, law firms, member representative groups and consumer protection bodies. A full list can be found at **Annex A**.

Analysis of responses

1. Scope of the charge cap

1.1 Transaction costs

Question 1: What are the advantages or disadvantages of extending the cover of the charge cap to include some or all transaction costs?

We received 61 responses to this question.

Summary of responses to question

We asked respondents for their views on the advantages and disadvantages of extending the charge cap to include transaction costs. A significant majority (75%) found that the disadvantages outweighed the advantages, citing that the lack of predictability in transaction costs may impact a scheme's ability to operate within the cap.

> *"Transaction costs (implicit and explicit) are unpredictable as they arise in response to Asset Managers reacting to investment opportunities and market conditions as they occur. Capping such costs may lead to poorer outcomes for scheme members as Asset Managers' investment behaviour might be constrained due to transaction cost considerations regardless of the potential positive outcomes for the scheme members."*
> ***Ballie Gifford & Co***

Whilst some respondents argued that including transaction costs in the cap may generally drive down costs for members, others felt that these costs cannot be influenced by trustees or asset managers and placing them within the cap, may limit an asset manager's ability to invest in the best interests of members.

> *"Whilst it is clear the inclusion of all transaction costs within the cap would provide better assurance as to the ex-post charges that would be borne by the members of a scheme, we have concerns that such a cap could create additional complexity (for both the fund manager and the consumer) and perversely could reduce consumer outcome by limiting the fund manager's ability to manage the fund as they intend (to deliver the best returns for the members)"*
>
> ***Financial Services Consumer Panel***

Some respondents also said that placing these costs within the cap will reduce the headroom that schemes currently have. This could affect investment strategies and may restrict asset managers' ability to invest in illiquids and other longer term investments, ultimately leading to poorer outcomes for members.

Some respondents commented on the impact of capping transaction costs on smaller schemes. It was felt that these schemes would not benefit from economies of scale in comparison to the bigger schemes and the unintended consequences would

be that smaller schemes could be squeezed out of the market, thereby limiting choices for the trustees.

The unreliability of the slippage cost methodology used for calculating implicit costs was also raised as a concern. Whilst this is the best available methodology, it is deemed to be unpredictable, particularly during volatile market conditions and could be prone to manipulation.

> *"In addition, calculating transaction costs using Slippage Cost methodology relies on a number of factors and can give rise to imperfect results. For example, reporting of negative transaction costs is not uncommon. Placing a cap on costs where imprecision exists seems to be counterintuitive."*
> ***Barnett Waddingham LLP***

Only a few respondents (8%) were in favour of including transaction costs within the charge cap. Of those in favour, one respondent felt that there is sufficient headroom in the cap to accommodate genuine innovation. Others were of the view that capping transaction costs will reduce member borne costs, incentivise savings and create a level playing field for members.

Question 2: What would be the impact on scheme member returns/industry if some or all transaction costs were covered by the cap?

We received 55 responses to this question.

Summary of responses to question

We asked how members/industry would be affected if some or all of the transaction costs were capped. The overwhelming view was that transaction costs should not be included in the cap as it would negatively affect performance and stifle innovation.

Some of the respondents indicated that in their view, transaction costs were an insignificant portion of a member's total expenditure and the impact in terms of costs reduction would be minimal.

> *"For most savers, transaction costs are such a small part of total expenses that their inclusion would be 'lost in the rounding'. At the same time, inclusion of transaction costs in the charge cap would risk introducing several unintended and potentially severe consequences in the form of perverse incentives which could affect investment manager behaviour….."*
>
> ***NEST***

The Pension Charges Survey 2020 also confirmed the average portfolio transaction cost (including funds with zero or negative charges) is 0.069%, excluding the funds with zero or negative charges increases the average to 0.083%. It also indicated that it is very rare for portfolio transaction costs to be above 0.2%.

Some of the respondents to the call for evidence pointed out that in some schemes transaction costs are being annually monitored by trustees in the Chair's Statement. This is corroborated by the findings of the Pension Charges Survey 2020, which confirmed that for unbundled schemes, board-level monitoring of transaction costs has increased from 70 percent of schemes in 2016 to 87 percent of schemes in

2020. However, providers still found it difficult to provide data on transaction costs at fund entry, due to difficulties in obtaining data and challenges in measuring it.

Some respondents stated that capping transactions costs could dis-incentivise assets managers from investing in alternate asset classes that incur higher transaction costs and could also prevent them from investing in response to prevailing market conditions. They advised that this could potentially limit investment options, reduce competition and ultimately lead to poorer outcomes for members.

> *"If transaction costs were to be included in the charge cap, there's a real danger it could stifle innovation within default investment strategies. Some asset classes, such as Property, which have delivered strong long-term returns, could not be included in a default strategy due to the high level of transaction costs attributed to the asset class. Infrastructure investment would also be more difficult should the cap be tightened. Diversification is key in a default proposition and including transaction costs in the charge cap could limit the number of asset classes which could be used."*
> ***Royal London***

Others suggested that costs should not be viewed in isolation but in conjunction with investment returns, value for money and availability of robust investment strategies.

Some respondents also highlighted practicality issues that could arise as a result of capping transactions costs. It was felt that transactions costs are generally retrospective and variable in nature and would be difficult to administer under the cap. It was also pointed out that in some cases some of the default funds would need revisiting and appropriate investment decisions taken to ensure compliance with the cap. This could be counter to the best interest of and returns for members.

Question 3: Should there be a combined transaction cost and charge cap, or should these be separate?

We received 57 responses to this question.

Summary of responses to question

We asked whether transaction costs should be combined within the existing charge cap, or capped separately. The vast majority of respondents were of the view that transaction costs should not be capped, whether separately or combined, as this would hamper the investment manager's ability to conduct transactions that yield better outcomes for members.

> *"Our belief is that transaction costs should remain outside of the charges cap and be uncapped in order to allow the investment manager to trade when considered necessary in the interests of investors."*
> ***True Potential Investments LLP***

However, if a cap were to be implemented, the general preference was for having a separate cap for transaction costs. It was believed that a combined cap would create challenges in terms of administration and difficulties in monitoring compliance.

> *"If transaction costs are to be capped, then there are advantages in keeping it separate from the charge cap. Separate caps provide greater transparency*

and avoiding the risk of cross-subsidies. Additionally, the administration of the current cap appears to be working, so it should not be tinkered with."
The Society of Pension Professionals

Only a few respondents opted for a combined cap. Of these, some felt that a combined cap would provide greater visibility of total costs and would make it easier for less engaged members to understand.

"Whilst separated costs allow for greater transparency, we believe a combined approach would be more advantageous."
First Actuarial

Question 4: Who should be responsible for complying with a transaction cost cap?

We received 56 responses to this question.

Summary of responses to question

We asked respondents who should have responsibility for complying with a transaction cost cap. The majority of respondents believed that governance bodies, trustees or Independent Governance Committees (IGC's) should be responsible for complying with a cap.

However, one respondent stated that trustees/IGCs are reliant on third parties to conduct these transactions and they may need to provide clear guidance to these third parties to ensure compliance, if transaction costs are capped. On the other hand, another respondent felt that it would be burdensome to require trustees to provide investment guidelines for asset managers.

Other respondents suggested that asset/investment managers and providers should be subjected to a 'comply or explain' framework for the charges they have incurred during the course of their transactions.

"If a transaction cost cap were to be introduced it would presumably have to follow the same requirements for compliance as the charge cap. However, in our experience of collating CTI transaction cost information, a statutory requirement for asset managers to report in a standardised cost template would make obtaining this information easier, particularly for smaller occupational pension schemes."
USS

Another option suggested was for fund managers to have responsibility for compliance with the cap. This is because they are conducting the actual transactions and would be better placed to have access to the relevant data to monitor costs in real time. However, it was also proposed that the trustees/IGC's should have oversight to ensure the costs incurred are not excessive.

"The fund managers should be responsible for complying with a transaction cost cap and reporting this to Trustees promptly. Alternatively, there needs to be a legal requirement for fund managers to disclose costs (including transaction costs and any changes to transaction costs) to Trustees promptly. The Trustee can then be responsible for complying with a transaction cost cap."

Workers Pension Trust

A couple of respondents were in favour of responsibility sitting with the platform manager, but few respondents felt that scheme providers and asset managers should hold responsibility. Another respondent also highlighted potential operational difficulties in assigning responsibility to a particular party for transaction costs incurred at default strategy level.

> *"The composition of some default strategies relies on funds being administered by more than one fund manager. An introduction of a transaction charge cap for this structure will be complicated to manage and further highlights the complexities that may be involved in controlling costs."*

The Investing and Saving Alliance (TISA)

1.2 Life Insurance

In the call for evidence, we highlighted concerns around the cost of the additional services incurred by members in default schemes who are unable to opt out of these arrangements. This relates to the appropriateness of defaulting people into arrangements they may not need or want, the detriment to members if the price of the add-ons increases and in general the transparency of non-standard add-on costs.

The Pension Charges Survey 2020 found bundled life insurance was not commonly offered by either provider's offering bundled schemes (four out of 20) or qualifying unbundled schemes (10 out of 33). Of the four providers offering bundled life insurance, only one passed the full cost of this on to individual members. Two providers offered bundled life insurance that was paid for in full by employers and the remaining provider had a number of legacy arrangements with employers in which the cost was split between them and the members themselves.

Whilst bundled life insurance was a little more common among qualifying unbundled schemes, in all cases, the full cost of the service was covered by the employer.

The Pension Charges Survey 2020 has identified that the number of schemes offering bundled life insurance is relatively small and the number of schemes where individual's must meet the full cost of that insurance, is even less.

Whilst the Government remains keen to ensure that charges borne by members only relate to services that add value to their pension saving, we have decided at this time that we will not be bringing forward legislative changes on life assurance, but we will keep this position under review.

Government response

The Government has considered the responses provided in the Call for Evidence regarding the inclusion of transaction costs in the charge cap and has decided that it is not appropriate to include transaction costs within the scope of the charge cap.

A minority of respondents (8%) were in favour of extending the scope of the cap to include transaction costs. Those in favour felt that there was sufficient headroom to allow for innovation and that having all member borne costs under one cap would provide greater transparency and a level playing field for members.

However, the majority of respondents (76%) felt that the disadvantages outweighed any potential benefit for members. Those against the cap highlighted concerns around complexities in fund administration, reduced headroom, restricted investment strategies, stifling of innovation and lack of flexibility to react to changing market conditions.

The Government recognises that there are circumstances where headroom gives schemes the financial flexibility to develop ideas and react to unpredictable market conditions such as Covid-19. It is also essential that asset managers have the ability to make the right investment choices for their scheme members and are able to use the tools at their disposal to manage volatility risks. The Government is also keen to encourage investments in illiquids and other alternative assets. Bringing transaction costs and the associated additional complexity into the cap could deter schemes from investing in such classes of assets, thereby restricting innovation and potentially yielding poorer outcomes for members.

Having considered all the options, the Government has decided that bringing transaction costs into the cap may be detrimental to member's interests, particularly in terms of fettering the ability of schemes to manage risks in volatile market conditions.

2. Level of the charge cap

Question 5: If we lowered the cap, what would be the impact on (a) scheme member outcomes (b) industry?

We received 63 responses to this question.

Summary of responses

We requested respondents' views on the impact on members and industry if the charge cap was to be reduced. There was limited support for reducing the level of the cap. Approximately 3% of the respondents felt that a reduction would be financially beneficial to members, particularly those in schemes that currently have fees close to the charge cap.

However, a significant majority (77%) of industry respondents were of the view that the current cap and competitive forces in the market had already led to charges for many default funds falling significantly below 0.75%, making a reduction in the cap unnecessary. The Pension Charges Survey 2020 supported this view. It found that all members in qualifying schemes are now below the level of the cap, with an average charge of 0.48%. Furthermore, charges in non-qualifying schemes have also fallen, where the average charge is 0.53% and 88 per cent of members are now below the cap level.

"The charge cap is doing its job and doing it effectively, and while the DWP is right to review both the level and the structure of the cap, we believe that there is not a solid nor rational case for a change in the overall level at this time."
Smart Pension

Respondents outlined the potential challenges that may arise if the level of the cap is reduced. They highlighted that such a reduction would restrict competition, innovation and impact on schemes' ability to invest in illiquids and other longer term assets such as infrastructure.

"A reduction of the charge cap would cut off DC savers from the investment opportunities and techniques they really need throughout their whole savings journey in order to optimise their retirement outcomes."
Pensions Management Institute

Respondents explained that sufficient headroom in the cap is required to adjust to changing conditions, including the cost of new innovation and regulations and periods of market volatility. They also highlighted that the headroom was needed to achieve reasonable returns on capital and improve the quality of investment offerings, including member engagement.

Question 6: How have investment approaches altered as a result of the introduction of the cap? What changes have there been in asset allocation, management style (active, passive, factor based)?

We received 50 responses to this question.

Summary of responses to question

We asked respondents whether investment approaches have changed as a result of the charge cap.

A number of respondents reported that they had not changed their investment approach as a result of the cap. However, there was universal acknowledgement across the responses that there has been an increase in passively managed portfolios. Respondents attributed this to a broad range of factors, with most identifying the competiveness of the charge cap as a key driver.

Respondents explained that providers were competing on cost to drive down charges further with some suggesting that far greater attention was placed on cost rather than value and/or performance.

"Since the introduction of the charge cap it is evident that DC schemes have become more fee conscious and generally need convincing of the additional value they will receive by selecting anything other than the cheapest option."
Aon

Others raised concerns that a further lowering of the cap will accelerate this trend, effectively slowing innovation, to the detriment of members and the wider market.

"This has reduced the range of investment opportunities and means many investment strategies are now immediately dismissed as DC pension candidates, either because they are actively managed or are perceived to be more expensive than the passive options currently available. This focus on cost is therefore limiting innovation in longer term investment strategy."

Standard Life Aberdeen

One respondent called for the mandatory disclosure of performance as well as costs in the Chair's annual statement.

Question 7: Have schemes changed administrator or asset manager in response to the cap?

We received 43 responses to this question.

<u>Summary of responses</u>

We asked whether schemes have changed administrators or asset managers in response to the charge cap. The general view across providers was that they have not changed administrator or asset manager in response to the cap. Some providers highlighted that the cost to access an investment was a key consideration in their investment manager selection process. It was suggested that this was driven by the downward pressure on the cap and scheme profitability.

> *"We do not have direct evidence of switching behaviour, but note that high administration fees crowd out the space left for investment approaches as a component of the charge cap, and have encouraged a focus on low cost investment approaches, products and governance."*
> ***The Pensions and Lifetime Savings Association (PLSA)***

Other respondents referred to evidence they have found in relation to administrators and asset managers having changed in light of general pressure on fees.

> "*We are aware of several instances where schemes have changed asset managers or strategies purely on grounds of cost. The reality is that if the primary goal of the pension scheme is to minimise costs, then switching investments is the most efficient way of helping to achieve this goal, due to the ease of switching and the fact that very low-cost investment products are available on the market."*
> ***Investment Association***

Question 8: What links have you found between cost and performance?

We received 49 responses to this question.

<u>Summary of responses</u>

The respondents highlighted that the relationship between cost and performance is "highly nuanced" and that it was difficult to conclude that performance has been "better" or "worse" for higher or lower cost funds. One respondent explained that, the market is still immature and only time and additional data will help to formulate the answer to this question

> *"It would very much depend on the time period over which performance was measured and the prevailing economic and market conditions during that time. At any given time, a higher cost fund may perform better or worse than a lower cost fund"*
> ***Legal and General***

There was a broad view that higher costs do not necessarily equate to better performance, but equally that lower costs do not necessarily equal better value for money either. Respondents highlighted that while the relationship between cost and performance is important, investment strategy and asset allocation is arguably the most crucial consideration in improving member outcomes.

Question 9: How much notice should be given for any reduction in the cap?

We received 56 responses to this question.

Summary of responses

We sought the views of respondents on the appropriate notice period if the level of the cap were to be reduced. The majority of respondents restated their view that the charge cap should not be lowered at present.

If a decision were made to lower the cap, respondents suggested that its implementation should consider the impact on business of recent unprecedented events such as Covid-19 as well as the administration changes to default funds that would be required. The notice period suggested varied between 12-18 months. It was suggested that the notice period required would be dependent on the level of reduction.

> *"Most of the authorised master trusts will take years and potentially decades to break even under the current charge cap. If this is reduced now, there will not be a well-functioning master trust market in the UK."*
> ***Pensions Management Institute***

Government response

The Government has considered all the views expressed in the Call for Evidence regarding the level of the charge cap. Only a couple of respondents (3%) felt that a reduction in the cap would be beneficial to members and achievable by scheme providers.

A significant majority (77%) felt that a reduction in the cap could negatively affect both members and industry. The key issues highlighted by the majority were the lack of headroom to manoeuvre when making investment decisions, restricted competition, stifling of innovation and investment strategies and a move towards passively managed funds.

The Government acknowledges the concerns raised by the respondents, particularly around the impact of market uncertainties from incidents such as, Covid-19. The Government recognises the importance of affording schemes the flexibility of using headroom to deal with these challenges.

The Pension Charges Survey 2020 findings also demonstrate that charges remain low. All members of qualifying schemes had ongoing charges that fell below the charge cap of 0.75% and the bulk of members of qualifying schemes are subject to fees some way below the charge cap limit, with 83 per cent subject to fees of 0.5% or less. Amongst qualifying schemes, contract-based schemes were the only scheme type where more than one in ten members experienced charges above

0.5%, with 47 per cent falling between 0.5% and the 0.75% cap. This indicates that most charges are significantly below the cap.

The Government accepts that the market will need to manage the next few years of change whilst still protecting members. The Government wants pension schemes to deliver good outcomes for members across their whole value proposition and to encourage competition on more than simply the lowest charges. The Government would encourage trustees to ensure they are also making the most of their ability to invest for the long term, taking advantage of the potentially higher returns available. We would encourage trustees to continue to invest in their data and administration platforms to ensure their schemes are robust and operationally resilient for the future.

Therefore, we will not be reducing the level of the charge cap at the present time.

3. Use of combination charges

Question 10: Do you agree with the suggestion to incorporate new conditions into flat fee structures? If not, what other ideas do you have to address the effect flat fees can have on small dormant/deferred pots?

We received 47 responses to this question.

Summary of responses

We asked respondents for their views on incorporating new conditions into flat fee structures and for ideas to address the effect of flat fees charges on small pots.

Many respondents were in favour of introducing a new condition on flat fees structures as a way to limit the risks of erosion of pot values, but there was also support for addressing the wider issue of small pot proliferation.

> *"We agree with the DWP that it is not tenable for members to be in a position where they can potentially lose all their savings and that the status quo should not persist. Having reviewed a number of options, we believe that a sensible balance would be to set the floor below which no-one should be charged at £50.00."*
> ***NOW: Pension***

Those against new conditions cited concerns about the impact on operating costs, adding further complexity to their charging structures and IT systems, and making communications to members more complex.

> *"The charging structures for auto-enrolment have already become far too complex for the average person to compare. Adding further fee conditions will turn AE into a quagmire of charges that no one will be able to navigate or understand."*
> ***PensionBee***

Some respondents felt a new condition could complicate resolving the issues around consolidation of small pots. Some felt that setting a de minimis pot size, before flat

fee charges would apply, would not tackle the underlying issue – instead they felt that the Government should focus any changes on addressing the proliferation of small pots.

Some of those who agreed that a new condition was appropriate responded with a suggested pot size de minimis range of between £50-£100 level. However, the lower figure was favoured by respondents as it struck a balance between protecting members resources and limiting any impact on the pensions market.

Question 11: Should any approach to limit flat fees apply for all scheme members with a pot below certain sizes, or only for deferred scheme members? At what level should the limit apply in each case?

We received 39 responses to this question.

Summary of responses

We asked respondents whether any approach to limit flat fee charges should apply to all scheme members below a certain pot size or to deferred members only. Some respondents (30%) were strongly opposed to any differential treatment between active and deferred members.

> *"The limit should apply to all scheme members. Many contributing members will be making small contributions and shouldn't be disadvantaged relative to deferred members."*
> ***Phoenix Group***

Some respondents also said that it would be an administrative challenge to differentiate between active and deferred members, which would lead to additional complexity and further cost. Some respondents also highlighted the ban on Active Member Discounts that came into effect from 6 April 2016.

> *"In light of rules around active member discounts, separating charging structures for deferred members does not seem appropriate.*
> ***The Society of Pension Professionals***

A small number of respondents argued that any approach to limit flat fee charges should apply to deferred members only. These respondents believed that the issue of the erosion of small pots was primarily an issue for deferred members where funds do not benefit from contribution inflows.

> *"All of the evidence presented to date indicates that deferred members are more likely to be adversely impacted by flat fees which would suggest that a limit, or a ban, should be restricted to that cohort."*
> ***Legal and General***

Question 12: Are you aware of any issues that would make it difficult to implement this kind of mechanism to limit flat fees, in particular, in relation to the broader issues around the desirability of consolidating small dormant/deferred pots?

We received 38 responses to this question.

Summary of responses

This question related to the example tiered approach to limiting flat fee charges set out in the Call for Evidence. A number of respondents were of the view that they were not aware of any barriers that would prevent a mechanism to limit such charges from being readily implemented. Whilst they suggested that there was a strong case for intervention, they indicated that there were important considerations and challenges with implementing this kind of mechanism, including communications to members that would have to be resolved.

> *"There are a number of aspects that could affect the successful implementation of a cap on an overall fee, such as communication with members and administration. However, we do not believe any aspect would be insurmountable."*
> ***Lane Clark & Peacock***

Other respondents felt that the suggested mechanism with different tiered limits would introduce complexity and would put a disproportionate burden on the administration of schemes. They reiterated that it was important to bring into effect a clean and simple to understand solution to the issue.

> *"Any decision to limit flat fees will introduce some implementation costs for amending systems and will impact the profitability of those parts of the master trust sector that currently employ this charging mechanism. Keeping any changes simple will reduce the costs of changing systems."*
> ***NOW: Pensions***

Some respondents were opposed to the incorporation of new conditions on flat fee structures on the premise that solving the proliferation issue of small pots would effectively resolve the problem of small and deferred pots from being eroded to zero. Respondents believe that limiting flat fee charges could disincentive the consolidation of small pots and complicate solving the small pot problems. Respondents were open to working with Government to formulate workable solutions.

> *"By restricting flat fees to a floor that is artificially below the cost of administering the pot creates the likely outcome that those pots will remain unconsolidated. This is regardless of whether the scheme or the member were the theoretical initiator of a transfer."*
> ***The Pensions and Lifetime Savings Association (PLSA)***

Question 13: What would be the impact on scheme members/industry?

We received 36 responses to this question.

Summary of responses

We asked respondents for their views on the impact on scheme members and industry if new conditions were imposed to limit flat fee charges. The majority of respondents were of the view that any mechanism that limits flat fees on small pots will benefit members. They also considered that maintaining public confidence in automatic enrolment was a priority.

> *"Concerns were noted about potential reputational damage for the industry if the current situation continues and flat fees continue to result in eroded pots. In general, the SPP feel that the industry will cope well with pretty much any*

change as it has done over the years. The key to successful adoption of change is to make the administration simple."
The Society of Pension Professionals

However, some respondents highlighted that schemes with a high proportion of deferred pots will be most affected, with changes impacting the finances available to run their schemes, stifling innovation and to a limited degree forcing providers to withdraw from the market.

"Incorporating new conditions into flat fee structures would delay the breakeven point of many schemes and potentially affect the financial sustainability of these schemes."
Workers Pension Trust

"The AE policy and price cap mechanisms are very successful policy interventions. We can see no reason to tamper with such success save for mandating that all providers have a "floor" below which flat charges cannot be levied with that floor being around £50 which our cost modelling suggests is fair to all parties concerned."
Creative AE

Government response

We propose to implement a de minimis pot size below which flat fees cannot be charged in default funds. We intend to set this initially at £100.

Having considered all of the evidence presented through the Pension Charges Survey 2020 and Call for Evidence, we believe there is a case for setting an initial de minimis at £100.This will help limit pot erosion and avoid pots being charged out to zero. This de minimis will apply to all pension pots to which the current charge cap applies.

We understand that setting the de minimis at £100 will have some financial impacts to some pension providers. The Pension Charges Survey 2020 found that 4 out of the 20 providers surveyed levied a flat fee on their members. Three of these providers were trust-based schemes and the other was a contract-based scheme. Based on these findings, it assumed that a minority of schemes operate a flat fee, whether on its own or part of a combination charge. The impact of this policy change would therefore not be expected to be widespread across the industry. We acknowledge, however, that some of the large master trusts that cover a significant proportion of the automatic enrolment market do operate under such a charging structure and this has informed where we propose to set the initial de minimis level.

The evidence we have gathered indicates that a £100 de minimis may lead those providers to consider increasing the costs charged to their other member with larger pension pots, to make up any shortfall. Government recognises this impact but believes setting the de minimis at this level will provide protection for a significant number of small pots. We will, however, undertake an impact assessment prior to introducing the de minimis.

Whilst the de minimis would apply to the flat fee element of the combination charge structure, it would not apply to any other ongoing percentage charge, so pension scheme providers may continue to charge for this element on pots of any size.

A number of respondents commented on the need to address the proliferation of small pots and the Work and Pensions Select Committee made a call to industry to submit feedback on potential workable solutions to reduce small pots as part of their response to this call for evidence. In September, the Government launched a cross-sector small pots working group to assess and make recommendations, as an interim step, on ways to tackle the challenge of deferred small pension pots. The working group has now delivered its report and its recommendations are being considered.

Following that consideration, Government will set out its next steps in seeking to reduce the proliferation of small pots. This work will also inform the timetable for increasing the de minimis level beyond the initial £100 level. As pot sizes grow, the Government will need to consider the balance between member protection and the financial sustainability of those schemes that charge flat fees. That financial sustainability will also be influenced by the changing cost profile of those schemes as they mature.

The Government is also aware that the current approved costs and charges used by the industry can be difficult to understand for scheme members and the public in general, and more importantly can make comparison of value for money between different pension schemes difficult. Therefore, the next phase of this work will be to explore how greater standardisation and clarity for the consumer can be introduced.

4. Standardised cost disclosure templates

Question 14: Is legislative intervention required to support the uptake of the CTI templates?

We received 54 responses to this question.

Summary of responses

We asked respondents for their views on whether legislative intervention was required to improve the uptake of the Cost Transparency Initiative (CTI) templates. Overall, there was support for a standardised disclosure process. It was felt that this would in the long term reduce costs and potentially increase benefits to scheme members.

Some respondents were in favour of mandating uptake of the CTI template to ensure transparency, consistency and timeliness in the cost and charges reporting framework.

However, the majority of respondents felt legislation was not required at this stage as the CTI process is still in its infancy and should be given a chance to bed in before legislative action is taken. Voluntary measures remain the preferred approach, with the caveat that legislation may be required at a later stage.

> *"NOW: Pensions welcomes a more consistent approach to cost disclosure and we support the Cost Transparency Initiative. However, we feel that we are still*

in the very early days of this concept. It would be preferable for Government to give the industry time to progress the use of CTI templates, to allow the processes to evolve and mature before codifying them in legislation..."
NOW: Pensions

Some respondents felt that further intervention is not required as uptake of the CTI template is increasing and introducing new conditions would be burdensome on industry and disproportionate in terms of benefits to the consumer.

"While it would be helpful to have costs supplied in a standard format, introducing this now may create further costs for fund managers, which are ultimately passed on to investors, and create additional delays as managers need to change the format of their reports to comply."
Willis Towers Watson

Others were of the view that uptake could potentially be increased via disclosure on the Scheme Return Form.

"Our view is that setting a requirement for trustees to disclose in the scheme return whether or not they have obtained disclosure from managers of charges on the CTI template would potentially be helpful in driving of the templates without penalising trustees if they did not (or were not able to) do so..."
Baker McKenzie

Question 15: How easy is it to request cost information from asset managers?

We received 45 responses to this question.

Summary of responses

Most respondents said it was easy to request and obtain cost information from asset managers. It was acknowledged that timeliness remained an issue but that this has improved recently.

The Pension Charges Survey 2020 reported that unbundled schemes found it easier to provide high level transaction cost data in comparison to the 2016 survey, as reporting requirements have now changed. However, providers are still finding it hard to provide data on transaction costs for fund entry due to difficulty in obtaining data and challenges in its measurement. This affects both larger and smaller funds.

Some respondents advised that there is no formal requirement for the cost and charges information relating to transaction costs to be provided within a particular timeframe and when the information is provided, it is often aligned to a date that is suitable for the investment manager.

"The challenge to schemes is not so much requesting information but obtaining it. Information is not always provided (there are still a surprising number of cases where it is just not obtainable, particularly for legacy arrangements, and these could well be the ones where the information is most relevant) and if it is it is not provided in a consistent format. Some asset managers will only disclose at a certain date which is not aligned to what is required."
The Society of Pension Professionals

Some of the respondents also reported issues with the quality of data being provided and the additional expenses incurred in cleansing this data.

> *"Where we have encountered significant challenges, however, is in the quality of data being returned by managers and the pace at which it is delivered. It can then become a lengthy (and potentially costly) process for clients or their advisers to work back and forth with the asset managers to clean and understand the data...."*
> ***AON***

Question 16: Do you believe that scheme members and recognised trade unions should have the right to request the information provided on the CTI template, and that a requirement to disclose this on request is proportionate?

We received 46 responses to this question.

Summary of responses

There was support for sharing CTI template information with members and trade unions. However, some respondents felt that costs disclosure information is readily available via the Chair's Statement and annual governance statements and that there is limited value in adding additional demands on trustees to provide this information in a different format (CTI).

> *"We are broadly agnostic on whether the information is shared with members and trade unions, however we would note the detailed information that is already disclosed within the Chair's Statement and question what additional value is added in requiring further disclosure. Additionally, the subject matter is complex (transparency would never have been an issue if it were not) so there is a risk that members could misinterpret the CTI information."*
> ***Barnett Waddingham LLP***

Some respondents raised concerns around the complexity and granularity of the CTI templates. It was felt that members could easily misinterpret the raw data on the CTI template and it would be more beneficial if they were provided with the costings detailed in the annual statements issued by trustees. These statements provide illustrative examples of how their pots are impacted and whether the costs incurred represents value for money for them.

> *"The CTI templates require additional qualitative assessment to interpret, so we would caution against making the raw data available widely without qualitative context. Further, we would note that the aggregated output is available in the DC Chair's Statement, where the transaction cost information is shown, more practically, per member investment option."*
> ***USS***

Others felt that looking at the charges in isolation could be misleading, as it does not take into account the other considerations that trustees have to bear in mind when making investment decisions, such as value for money, investment strategy, fund performance, discounts etc.

> *"We are supportive of scheme members and recognised trade unions requesting transaction costs to making informed decisions. Whilst there may be merit in*

providing transaction cost data, there could be consequences if the charges are looked at in isolation without taking into account other elements such as investment strategy, discounts, performance and overall value for money. The CTI template provides a large amount of data at a very granular level that individual members may not be able to interpret.”
Phoenix Group

One respondent stated that costs disclosure to trade unions and members via the CTI methodology would only work if asset managers were also mandated to provide their returns using the CTI templates. Otherwise, it would become an onerous and costly task for trustees.

“We would consider that scheme members and recognised trade unions could have the right to request this information in the CTI template only if it has been legislated that investment managers must declare costs in the CTI template, otherwise this requirement would be unduly burdensome on Trustees and/or they would have to spend more money on advisers”
Gowling WLG (UK) LLP

Question 17: Should DB schemes be required to adhere to the same standards?

We received 48 responses to this question.

Summary of responses

In their report into the pensions costs and transparency inquiry, the Work and Pensions Select Committee recommended that the Government should mandate the use of the CTI disclosure templates for both Defined Contribution (DC) and Defined Benefit (DB) pension schemes. We asked respondents whether DB and DC schemes should adhere to the same standards.

Almost half of the respondents were in favour of DB schemes being required to adhere to the same standards as DC. It is believed that standardisation will improve consistency and transparency in the costs and charges disclosure regime.

“Given the significant focus on transparency of charges across the investment industry, we believe that the trustees of DB schemes would benefit from more transparent investment costs and that there should be a standard way for reporting these.’”
Lane Clark & Peacock

Some of those against the standardisation of DC and DB processes cited the differing nature of DB schemes where the employer carries the risk instead of the member. The existing fiduciary duty of DB trustees was also perceived to be sufficient criteria for making investment decisions. It was felt that aligning the two processes would place an unnecessary burden on DB trustees when it would not directly impact on member outcomes.

“DB trustees are subject to fiduciary duties in terms of how they select investments and placing additional burden on DB trustees by setting requirements for them to adhere to may not have a direct effect on member outcomes, and would not in our view be desirable. However, DB trustees do

require knowledge of the charges and operation of investments, and so increased uptake by the industry of CTI templates across DB and DC would in our view be beneficial to DB trustees in selecting investments."
Baker McKenzie

Question 18: What are the barriers to using the information obtained when making decisions?

We received 41 responses to this question.

Summary of responses

We asked respondents whether there were any barriers to using the CTI information when making decisions. There were mixed views on barriers to using template information for decision making. Some respondents stated that due to the technical nature and complexity of the information on the CTI template, trustees/Independent Governance Committees(IGCs) may require support from consultants to understand the context of the data provided.

The main barriers identified were inconsistencies in relation to format, approaches adopted by asset managers and the lack of historical datasets to facilitate meaningful comparisons when making investment decisions.

"Consistency—different asset managers will take different approaches to completing the template for similar mandates. For example, some 'fund of hedge fund' managers will only include the high-level costs whilst others will include all the underlying manager costs as well. This makes comparisons for clients difficult, if not impossible."
AON

Other barriers identified include reliability of the data provided, lack of risk data on the templates and timeliness. The methodology for calculating implicit costs (slippage) was also highlighted as a barrier to using the information obtained for decision making purposes.

'There are no real barriers to using the information obtained, other than limitations imposed by the inadequacies of the slippage methodology. As we have previously argued, the slippage methodology is the best available method of judging implicit costs but is flawed.'
The People's Pension

Government response

In its response to the Work and Pensions Select Committee's recommendation to mandate the CTI disclosure templates, the Government stated that it would consider consulting on the use of secondary legislation to encourage the use of the templates.

The Government sought the views of relevant stakeholders in the Call for Evidence on this issue. Almost half of respondents felt that legislative intervention is not required. Approximately 37% felt that there is benefit to having a single reporting structure, but that it is too early for legislative intervention and the voluntary use of

CTI templates should be given a chance to work. Some of the 37% of respondents felt that the DC workplace pensions template (DCPT) is working well and that mandating for the use of the CTI would create unnecessary burden for providers.

Around 22% believe that legislative intervention would be required to improve transparency and consistency in the reporting process.

The Government believes that consistency of information and transparency are key to ensuring that value for money is delivered to pension scheme members. This is in line with the 2019 Works and Pensions Select committee recommendations. We note the call to give the CTI process time to bed in. The CTI templates were launched in May 2019 and we recognise that it will take industry time to continue to adapt their processes to adopt the templates. Nevertheless, the Government is committed to ensuring the transparency of costs and charges information for the benefit of pension savers and we look to legislate in the due course to enable this, if take-up is not sufficient.

Conclusion

Having considered all of the responses to the Call for Evidence and the findings from the Pension Charges Survey 2020, the Government does not feel that it is appropriate to extend the scope of the charge cap to include transaction costs.

The Government will not directly lower the level of the cap at this stage. The evidence indicates that including transaction costs in the charge cap may stifle innovation and diversification and the ability to manage volatility risks. The evidence from the Pension Charges Survey 2020 also indicates that the average charge across the schemes is well below the cap level and there is increased monitoring of transaction costs at board level in un-bundled schemes.

The Government remains committed to transparency of all costs and charges borne by pension scheme members. We will closely monitor the uptake of the use of costs transparency initiative templates and will legislate if that does not occur.

To recognise the increasing importance of addressing the issue of small pots and the need to take action prior to tackling the longer term proliferation of such pots, the Government will be taking forward legislation to introduce a de minimis on individual member's pots, initially set at £100, below which flat fees cannot be charged. If a member has multiple pots in the same scheme, the de minimis will apply to all pots that are being charged. However, it is expected that schemes will consider consolidating these pots in the long term.

Annex A – List of respondents

We received 68 responses from the organisations listed below. Individual respondents have not been named.

Aegon

AgeWage

AJ Bell

AllianceBernstein

Alternative Investment Management Association (AIMA)

Aon

Association of British Insurers (ABI)

Association of Consulting Actuaries

Association of Investment Companies

Atlas

Aviva

Baillie Gifford

Baker McKenzie

Barnett Waddingham LLP

BCF Pension Trust

Blackrock

British Private Equity & Venture Capital Association

Business Growth Fund (BGF)

ClearGlass

Creative AE

DC Investment Forum

Fidelity

Financial Services Consumer Panel

First Actuarial

Fulcrum

Gowling WLG (UK) LLP

Hargreaves Lansdown

Hymans Robertson

Investment Association

ITV

LCP

Legal & General

M&G

Mercer

NEST

NOW Pensions

O'Connor & Co (Financial Services)

Octopus Group

Pension Administration Standards Association

PensionBee

Pensions Management Institute

Pensions Policy Institute

Philip J Milton & Company

Phoenix Group

Pinsent Masons LLP

The Pensions and Lifetime Savings Association (PLSA)

Reassure

Royal London

Royal Mail Group

Sackers

Schroders

Scottish Widows

Smart Pension

St. James's Place Wealth Management

Standard Life Aberdeen

State Street

The Co-operative Group Pension Scheme (Pace)

The Investing and Saving Alliance (TISA)

The People's Pension

The Society of Pension Professionals

True Potential Investments LLP

UNISON

USS

Which?

Willis Towers Watson

Workers Pension Trust

XPS Pensions Group

Zivot