Department for Work & Pensions

Permitted Charges within Defined Contribution Pension Schemes

Publication date 24 May 2021

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Introduction

In the Government's 'Review of the Default Fund Charge Cap and Standardised Costs Disclosure' published on 13 January 2021, we set out our intention to introduce a threshold – or 'de minimis' - below which the flat fee element of the combination charge used by pension providers, cannot be charged to members. The de minimis will be set at £100.

The de minimis will only relate to the flat fee component of the combination charge. This means that a percentage of funds under management charge can still be charged on all pots, irrespective of the pot size.

We are now consulting on the policy around the implementation of the de minimis and also on the Statutory Instrument required to bring about this change.

Alongside this consultation, we have published our consultation stage regulatory stage impact assessment on the de minimis on flat fees. Your responses to this consultation may be used in the final stage regulatory impact assessment which will be published alongside the laying of amending regulations to bring this change into force.

We are also using this opportunity to seek views on the broader direction we should take on the future structure of charges that are permitted within the charge cap. This consultation sets out the Government's proposal to move to a single, permitted universal charging structure for use within the default fund of qualifying Defined Contribution pension schemes used for automatic enrolment.

About this consultation

Who this consultation is aimed at

- pension scheme service providers, other industry bodies and professionals
- pension scheme trustees
- civil society organisations
- pension scheme members and beneficiaries
- any other interested stakeholders.

Scope of consultation

Pensions policy is a reserved matter in Scotland and Wales, this consultation therefore applies to England, Wales and Scotland.

It is envisaged that Northern Ireland will make corresponding regulations.

Duration of consultation

The consultation will run for 8 weeks, starting on 24 May 2021 and ending on 16 July 2021. Please ensure your response reaches us by that date as any replies received later may not be taken into account.

How to respond to this consultation

Please send your consultation responses to:

Email: pensions.charges@dwp.gov.uk

Note: When responding please indicate whether you are responding as an individual or representing the views of an organisation.

Government response

We will aim to publish our response to this consultation on the GOV.UK website later this year.

How we consult

Feedback on the consultation process

We value your feedback on how well we consult or seek evidence. If you have any comments on the process of this consultation (as opposed to comments about the issues which are the subject of the consultation), please address them to:

DWP Consultation Co-ordinator
caxtonhouse.legislation@dwp.gov.uk

Freedom of information

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

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.

To find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact the Central Freedom of Information team: freedom-of-information-request@dwp.gov.uk.

The Central Freedom of Information team cannot advise on a specific consultation exercises, only on Freedom of Information issues. Read more information about The Freedom of Information Act.

Ministerial foreword

In January of this year, my Department published its *Review of the Default Fund Charge Cap and Standardised Costs Disclosure*, and set out proposals which represent a significant step in ensuring that the consumer comes first.

In that review, I set out my commitment to protect individuals who are automatically enrolled into a qualifying, defined contribution pension scheme from high and unfair charges and from the risk of erosion to their pension savings from such fees. This consultation is the next step in that process, and gives you an opportunity to comment on the implementation of a limit on member paid flat fees, to curb the erosion of small pots.

We all know what a success automatic enrolment has been in getting more people saving into private pensions - over 10 million employees have been automatically enrolled into a workplace pension since 2012. Many of those savers will continue to grow their pension over the longer term. However, we know that for some, particularly those that regularly undertake short-term employment and change jobs frequently, there is a greater likelihood that they will be automatically enrolled into new workplace pensions a number of times. It is this group we are seeking to help by the measures set out in this consultation.

We know that pension providers must be able to charge members for the services they provide, and this measure will only apply to pensions schemes which use a flat fee combination charge, and will only be applicable to pots valued at £100 or less. Providers using this type of charge may continue to charge members the percentage charge element, as is the case now.

This measure is a first step in putting the member first. However, I also want to look ahead to how we can drive greater member awareness of their pensions, and enable them to make informed choices over the product that is best for them.

In our Review, we said that in 2021 we would look at how we could make it as easy as possible for pension savers to have access to comprehensive and transparent information on costs and charges. I believe that moving, in the future, to a single, universal charging structure could make a significant difference to the transparency of charges, make comparison easier, and unlock greater choice for members.

I know, however, that the lowest price product may not necessarily always be the best one for the member. It may not deliver the required retirement income they need, or it may not fulfil other preferences, perhaps including how, or in what types of pension product, their money is invested. We will use this consultation to consider your views on how these wider considerations could inform our policy on a single charging structure.

We also know that employers have a pivotal role at the start of and throughout an employee's automatic enrolment pension journey. I believe that they too can benefit from more clarity on rates of member borne charges offered by providers, in their decisions about which pension scheme is right for their employees. I also want to use this consultation to explore how the employer's responsibilities may influence an employee's decisions to switch to an alternative fund or provider.

I acknowledge that those providers that use combination charges are most likely to face challenges in adapting to these measures, so I am keen to hear the views of the industry on how any transition could be managed.

The proposals in this consultation document are rightly focussed on my ambitions to benefit members of pension schemes used for automatic enrolment and ensure both their pension pots are protected, and that in the future, they have greater clarity of the charges they pay, can feel more engaged with their pension, and make informed choices going forward.

Guy Opperman MP

Minister for Pensions and Financial Inclusion

Chapter 1: Permitted Charges within the Charge Cap

1. The Charge Cap was introduced in 2015, and relates to charges which may be borne by scheme members of the default fund within certain pension schemes used by employers to meet their automatic enrolment duties. The cap is set at 0.75% of a member's funds under management, under a default arrangement or an equivalent combination charge.

2. In setting the charge, the Government also introduced three permitted charging structures, which providers may use to charge their members. These structures are set out in the Occupational Pension Schemes (Charges and Governance) Regulations 2015. Broadly, the charging structures are:

    - a single percentage charge of the pot value, taken at the end of each year and capped at 0.75% of funds under management;
    - a combination of a percentage charged on each new contribution made, plus an annual percentage of funds under management charge;
    - a combination of a monthly or annual flat fee plus an annual percentage of funds under management charge.

3. Permitting three different charging structures, has supported the expansion of pension provision under automatic enrolment by enabling the creation and growth of new schemes, such as master trusts, to provide savings vehicles for different groups of members.

4. This document is seeking views on two measures involving the charging structures that are permitted within the charge cap. Firstly, our intention to limit erosion of small pots, by limiting the charging the flat fees, is discussed in chapters 2 to 5. Secondly, looking forward, our proposal to move to a universal charging structure in the future, in order to increase comprehension of charges and drive member engagement, is discussed in chapters 6 and 7.

Chapter 2: Protecting members with small pots

5. One of the Government's priorities is to protect individuals who are automatically enrolled into a qualifying, defined contribution (DC) pension schemes from high

and unfair charges and limit the risk of erosion to their pension savings from such fees.

6. Whilst automatic enrolment has been a huge success, some employees, particularly those on the lowest incomes, are more likely to change jobs more frequently, with a resulting increase in the number of deferred small pension pots.

7. The Pensions Policy Institute (PPI) estimate that, without intervention, the number of deferred pension pots in Master Trust schemes could increase from 8 million to as much as 27 million by 2035[1]. The proliferation of small pots is a cause for significant concern within the automatic enrolment workplace pensions market, as it presents a number of risks for scheme members, pension providers and the reputation of automatic enrolment.

8. For members with small pots, particularly those with deferred pots, these risks include the possibility of pot erosion where their pension provider 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 revenue generated. The charging out of very small pots may risk undermining the progress made in normalising pension saving under the hugely successful automatic enrolment policy.

9. The Government needs to strike a balance between protecting members, especially those with small pots, and maintaining the financial sustainability of scheme providers. In our 2020 Review, we have concluded that it is right to set a de minimis pot size below which flat fees cannot be charged. We therefore intend to amend The Occupational Pension (Charges and Governance) Regulations 2015 to introduce the de minimis, and we are using this consultation exercise to consult on these draft regulations.

The Small Pots Working Group

10. A number of respondents to the 'Review of the Default Fund Charge Cap and Standardised Costs Disclosure' 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 the growth in the number of small pots as part of their response to this call for evidence.

[1] https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf

11. In September 2020, the Minister for Pensions and Financial Inclusion set up a cross-sector Working Group, chaired and facilitated by the Department for Work and Pensions (DWP) to make recommendations to Government, on ways to tackle the growth of deferred, small pension pots in the Automatic Enrolment workplace pensions market. The Working Group report was published on the 17 December and the report provides an important step in finding workable solutions to tackle the growth of deferred, small pots. It is clear from the Working Group that more needs to be done by pension providers, working together with regulators and Government, to tackle administrative challenges to enable low-cost mass market transfers and consolidation.

12. The Pensions and Lifetime Savings Association and the Association of British Insurers have jointly convened a new industry co-ordination group to take forward the DWP chaired Small Pots Working Group recommendations. The co-ordination group will bring together relevant work from across industry, focusing on the administration processes that will underpin a long-term future consolidation model. Examining existing data-matching requirements, common data standards and the requirements for a low-cost transfer process. The group will provide a progress report in the summer.

13. Any future policy proposals related to the de minimis that go beyond those set out in this paper, will be considered alongside work to explore solutions to tackle the growth of deferred small pots.

Chapter 3: Policy on flat fees

The 2020 Review

14. On 13 January 2021 the Government published the findings of the 2020 'Review of the Default Fund Charge Cap and Standardised Costs Disclosure'. That review commenced with a Call for Evidence, published in June 2020, which set out a series of questions regarding the level and scope of the charge cap. This included the charging structures; the effect of flat fees on small pots erosion; and the use of standardised cost disclosure templates.

15. As part of the review, we considered how members with small, particularly deferred pots, which are subject to a combination charge, involving a flat fee element, run the risk of their pots being eroded.

16. Many respondents to the review were in favour of the proposal to incorporate new conditions to the flat fee charge structure. There was also strong support for

addressing the wider issue of small pot proliferation as a way to limit the impact of flat fees charges, across multiple small pots.

17. Some industry respondents raised concerns about the implications of setting a de minimis, particularly around the financial sustainability of providers who offer automatic enrolment pensions to lower earners as the market continues to mature.

18. However, our review concluded that setting a de minimis on the use of the flat fee element of the combination charge would be the best approach to protect members from the risk of pot erosion and from having their hard earned savings charged out to zero.

Scope of the de minimis

19. There are three types of charging structure that are permitted for use by pension providers on savings that fall within the default funds of qualifying workplace pension schemes used for automatic enrolment.

20. These different structures provide their own benefits to both members and providers. We describe these structures and their respective benefits in more detail in **Annex A**.

21. The de minimis will apply only to the flat fee element of the combination charge. The other element of this combination charge – a percent charge based on the member's value of funds under management, is unaffected by the de minimis, and may continue to be charged on any value pot.

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

23. Evidence collected from the responses to our 2020 Review make clear that setting the de minimis at £100 may have financial impacts for some pension providers. The Pension Charges Survey 2020 found three trust-based providers levied a flat fee on their members. Since the survey we are aware that more providers have adopted a flat fee structure however, we believe that the majority of providers do not charge a flat fee. Therefore, we believe the impact of this

change would not be widespread across the industry. Any burdens created need to be balanced against the importance of protecting savers from unfair charges, and limiting the erosion of pension savings.

24. Whilst our review concluded that a de minimis should be implemented, the review did not specify whether it should apply to both active and deferred pots, or just one group. In our Call for Evidence, we sought views on the scope of a de minimis, but there was no firm consensus on this issue. The responses received represented both points of view.

25. On balance, we propose that the de minimis should apply to all members, as this may minimise any additional complexity for providers in trying to differentiate whether a pot is deferred or active. It is also noted that even active members with small pots may see some erosion of their pots albeit for a shorter time. Therefore, to ensure a consistent and fair approach we feel that is right to protect both active and deferred members from this risk.

Question

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

Application of the de minimis

26. In the 2020 Review, we explored the possibility of introducing a tapering system, were a de minimis to be implemented. This would have meant that the maximum value of a flat fee that could be charged would increase with the pot size, for example pots under £100 would have no flat fee charge, pots between £100-£200 could charge up to £5 flat fees, and so on. However, having considered this further we do not plan to implement any tapering measures. We feel that such an approach may add complexity to this combination charge for both members and providers.

27. Instead the de minimis will apply to all pots valued at £100 and below. This means that no flat fee or proportion of a flat fee can be charged to a pot worth £100 or less. However, when the pot has a value of £100.01 or more a full or partial flat fee may be charged.

28. Providers may levy their flat fee as a monthly or annual charge and on some occasions, the flat fee and annual percentage charge may be charged to the pot at the same time. For example:

    a. For any pot worth £100.01 or more, and for any month where the flat fee is payable, providers will be able to charge a full or partial flat fee to the pot until the pot reaches £100.

b. For any pot worth £100.01 or more, and for any month where both the annual percentage charge and flat fee are payable, the percentage charge should be applied first, and then if the value of the pot is worth £100.01 or more a full or partial flat fee can be applied.

29. **Annex B** provides illustrative examples of how the de minimis works for pots worth around £100. It also considers how to manage the annual percentage charge and flat fee when they are payable in the same month.

30. If a member has multiple pots with other providers, who charge flat fees, the de minimis would apply across all of their pots. As is the case now, members with multiple pots with the same provider can only be charged once.

31. Since the de minimis will only apply to the flat fee element, there will be no impact on the application of the percentage charges element of a combination charge. The percentage charges would still be applied on any pot size.

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

Timescales for implementation of de minimis

32. We currently envisage that the legislation required for the implementation of the de minimis will come into force in April 2022, subject to other parliamentary priorities. We hope that this should allow sufficient time for organisations to prepare for this change. However, we would like to know if the proposed implementation date is feasible for your organisations.

Question
3. Would proposed implementation in April 2022 create any business or operational challenges?

Review of de minimis level

33. In the 2020 Review, we said that the de minimis would be set at £100, and that we would keep the level under review, with a view to raising it at some stage in the future.

34. We intend that any future change to the level of the de minimis will be considered alongside any potential solutions to tackle the proliferation of small pots and any future reform of the permitted charging structures.

Chapter 4: Statutory Instrument

The Occupational Pension (Charges and Governance) Regulations 2015

35. The Secretary of State for Work and Pensions, in exercise of the powers conferred by paragraph 1(1) of Schedule 18 of the Pensions Act 2014 proposes to make the following amendments to The Occupational Pension (Charges and Governance) Regulations 2015:

Citation, commencement, extent and application

—(1) These Regulations may be cited as the Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2021 and come into force on 6th April 2022.

These Regulations extend to England and Wales and Scotland.

These Regulations apply to England, Wales and Scotland.

Amendment of the Occupational Pension Schemes (Charges and Governance) Regulations 2015

In regulation 6 of the Occupational Pension Schemes (Charges and Governance) Regulations 2015 (limits on charges) (2)—

at the beginning of paragraph (4)(a) insert "subject to paragraphs (5) and (6),";

after paragraph (4) insert—

"(5) The flat fee charge under paragraph (4)(a) may only be levied where the value of the member's rights under the scheme is more than £100.

(6) Where the flat fee charge under paragraph (4)(a), if levied in its entirety, would have the effect of reducing the value of the member's rights under the scheme to less than £100, that charge may only be levied to the extent that it does not reduce the value of those rights to less than £100.

(7) For the purposes of paragraphs (5) and (6), the value of the member's rights under the scheme is to be calculated after taking into account the existing rights charge under paragraph (4)(b).

Question

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

(2) S.I. 2015/879. Relevant amending instrument is S.I. 2017/774.

Chapter 5: Impacts of a de minimis

36. A consultation stage regulatory impact assessment estimating the impacts of the de minimis on flat fees, has been published alongside this consultation. At this stage we have not estimated the full financial cost to businesses and we would welcome further evidence on this. Alongside questions in the previous chapters we have some more detailed information we would like to collect. Any further evidence or data you can share is appreciated.

37. In preparation for the final stage regulatory impact we would welcome evidence on the financial costs and benefits to business and members. This includes any one-off or ongoing costs associated with adopting the de minimis. This may include but is not limited to the costs of changing IT infrastructure, communications with members, loss of revenue and impacts on future planning or investments.

38. As well as the financial impacts we are keen to understand the steps you will need to take to adopt the de minimis especially if you expect to make significant changes to your infrastructure or communications. There may be some other members who will be indirectly impacted by the de minimis. For example, those members with pots larger than £100.01. We would like to know more about potential indirect impacts on these members

39. We also understand there are some impacts that you may not be able to monetise. We welcome any evidence you can provide on any other non-financial impacts to your business or members. This may include member engagement or the reputation of the wider industry.

40. We recognise the challenge small pots present to the industry and members. We would be interested in finding out more about the extent and types of members who may be affected by de minimis. Any data on the number of pots you have that would be affected as well as the characteristics of members who own those pots would be welcomed.

41. If there are any other impacts not mentioned, please outline these with evidence or data where possible.

Questions

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

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

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

Chapter 6: Future reform of permitted charging structures

42. In Paragraph 2 we briefly set out the three permitted charging structures, and have described them in more detail in **Annex A**. By permitting three different charging structures, we created an opportunity for different groups of employees to benefit from automatic enrolment, and save towards their occupational pension.

43. This approach also allowed some flexibility to pension scheme providers to set charges which, whilst meeting the overall requirements of the cap, enable them to meet the needs of the sectors of the labour market they are servicing (including those sectors with high job churn) and their particular business model.

44. The majority of members of automatic enrolment pensions remain in the default fund provided by their employer. This fund will continue to suit many employees. However, for others, personal and financial circumstances and preferences may change, so the price they pay, the value they receive or the way their fund is invested, may no longer be right for them. So it is right that we look at how employees can become more engaged with their pensions, and consider how they can better compare pension products, to ensure they have a pension that is right for them.

45. Following the publication of the Review of the Default Fund Charge Cap, we have considered the present permitted charging structures, and we believe there is a risk that these varied charging structures, within the same automatic enrolment market may be acting as a barrier to members' better understanding and ability to compare the costs of their pension with other pension products and schemes. We are seeking input to understand and gather further evidence in relation to this through this consultation process.

Member engagement

46. Automatic enrolment requires employers with at least one member of staff to enrol their eligible employee(s) into a workplace pension scheme and for the employer and member to contribute towards it. Automatic enrolment does not require the employee to do anything to be enrolled into a pension scheme. This employee inertia is strong and the opt-out rate has remained consistently low, with less than 1% of eligible savers actively choosing to stop saving per month, as at end of June 2019[3]

47. We know that many employees do not engage with their pension. Indeed, the 2017 FCA Financial Lives[4] survey found that:

- 45% of people do not give their pension 'much thought' until they are two years from retirement - citing a lack of time;

- 18% of those with a DC pension had given 'a lot of thought' to how much they should pay into their pension; and

- 39% hadn't considered this at all.

48. Similarly, data from the Pensions Regulator shows that only 5% of members in DC schemes are not invested in the scheme's default strategy. Therefore, 95% of members are likely to have given little thought about which pension fund they should invest in. This is even higher in Master Trusts where the Pension Policy Institute found 99% of Master Trust members were in the default strategy.

49. An effect of the current permitted charging structures for members is that charges that fall within the charge cap, are not universally like for like. For engaged members wishing to compare pension products based on price, this is likely to be difficult. Nor are there any independent product comparison services for occupational pensions at present, to assist members in comparing products.

50. However, the charge cap does offer protection to members, and should be a consideration for members who may consider switching their pension elsewhere.

[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/883289/automatic-enrolment-evaluation-report-2019.pdf

[4] https://www.fca.org.uk/publication/research/financial-lives-survey-2017.pdf

Chapter 7: Moving to a Universal Charging Structure

51. The purpose of a universal charging structure will be to enable better member comprehension of the charges they pay, and of their pension's other features, and in doing so, improve member engagement. This in turn may enable members to compare pensions, and exercise choice where they feel an alternative pension product could more closely meets their needs. We would like to gather evidence in this area as part of the consultation process.

52. The role of employers is fundamental to the choice of pension an employee is enrolled into. We will carefully consider how their role may influence or impact, if at all, a member's preference to switch funds within their existing provider, or switch provider completely, as a consequence of the proposal in this consultation. For example, how might the employer's mandatory contribution, influence the member's decision on switching?

53. We are also aware that the impact on market behaviours are also uncertain, including among pension providers who currently accept all employers and/or who serve lower paid sectors of the labour market.

54. We are seeking your views on the following proposal:

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

55. When the charge cap was implemented in 2015, pension scheme providers were free to choose which of the three permitted charging structures they should adopt. Their choices would have been driven by their particular business model, and the profile of employer and employee they planned to attract.

56. The proposal to move to a universal charging structure within the default fund arrangement, based on a single percentage charge for member borne costs, will inevitably impact on some providers who use an alternative charging structure. In particular this could impact on Master Trust schemes which serve most of the automatic enrolment market, given the Master Trust industry is unlikely to

breakeven until around 2025[5]. The largest Master Trust is NEST, which itself charges members via a combination charge structure. NEST has a public service obligation to accept all eligible individuals automatically enrolled by their employer, even if the charge income derived from the member does not meet the cost of administering their pension. Any potential impact on existing, or potential members from this proposal will be carefully considered alongside responses received.

57. Findings from the Pension Charges Survey 2020[6] found two of the 20 providers surveyed used a contribution charge in combination with a percentage charge[7]. In addition, there were three trust-based and one contract-based provider who levied flat fees on their members. The survey accounts for 29.3 million pension pots and included the 10 largest providers. Since the survey was conducted we are aware more providers may have adopted flat fees structures. We would expect these providers to be affected by changes to the charging structure.

58. We would welcome your thoughts on the following questions:

Questions

8. Do you think that members (in particular AE) have an understanding of your scheme costs and charges? If so, what evidence do you have to support this?
9. Does the current system impede members from carrying out a comparison of costs and charges between different schemes? If so should the system be reformed to allow for simple price comparison of costs and charges?
10. Do you agree that the Government should move to a universal charging structure within the default fund arrangement? If so how best could the Government implement this change in order to manage the impact on the industry and members?
11. What are the benefits of standardisation for other government initiatives such as simpler statements and the pensions dashboard?

[5] PPI 2020: https://www.pensionspolicyinstitute.org.uk/research/research-reports/2020/2020-08-27-financial-sustainability-of-master-trust-pension-schemes/

[6] https://www.gov.uk/government/publications/pension-charges-survey-2020-charges-in-defined-contribution-pension-schemes/pension-charges-survey-2020-charges-in-defined-contribution-pension-schemes

[7] DWP 2020: https://www.gov.uk/government/publications/pension-charges-survey-2020-charges-in-defined-contribution-pension-schemes/pension-charges-survey-2020-charges-in-defined-contribution-pension-schemes

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

Improving member comprehension and cost comparability

59. We believe that some members may increase the value for money from their occupational pension, and their overall preparedness for retirement, by being presented with information about their pension in the clearest, most understandable way possible. There is no one single approach that can achieve this objective, however we are already introducing the pension dashboards, and simpler benefit statements aim to significantly increase clarity of pension information.

60. However, in using these new tools, members could still face barriers to understanding their own charges, and how they compare to charges on other pension products.

61. Our proposal for a universal charging structure within the default fund arrangement would facilitate improved comparability of cost and charges between different pension funds for those members who wish to compare the charges for their present fund. Such comparisons against other funds or schemes, would help them to make an informed choice about which pension might be right for their personal circumstances.

62. We also need to consider what action a member will choose to take, if any, after receiving information on the charges they pay, where they are better able to compare charges.

63. Members may already choose to move their pension pot to another product from their existing provider, or to a different provider altogether, but in doing so may face exit or entry charges. Some providers do publish comparative information about their own and other providers' charges, product features and services, that savers may consider. However, this proposal will make price comparison easier and more likely amongst members.

Question

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

Wider Value Considerations

64. The value of a workplace pension to some members is likely to extend beyond the price of the member borne charges applied to it. Other factors may be equally or more relevant to members who may wish to compare or switch from their current pension product to another. These other factors include:

- potential higher investment returns of other products, or providers;
- ethical or religious preferences, eg sharia investments, and those that invest in environmental measures;
- whether the fund is actively or passively managed;
- impact of loss of employer pension contribution;
- additional charges outside of the cap, eg entry/exit charges;
- the protection offered by the charge cap.

65. Each of the three current permitted charging structures provides its own benefits and disadvantages to members and providers. We know for example that combination charges can offer members with larger pots, a lower overall charge alternative to members with larger pots who contribute into a pension which uses a single annual management charge.

66. Moving to a universal charging structure, would mean that some members currently paying a combination charge are likely to pay more when charged under a single annual percentage charge, without necessarily securing a higher return.[8] Members with lower value pots may see charges fall under a universal charging structure which uses a single percentage charge, compared to the charges they paid under a combination charge. A single percentage charge approach may mean that active members with larger pots, moving from a contribution charge arrangement, may cross subsidise the costs of scheme membership for members with lower value pots.

Existing announcement related to the charge cap

[8] https://www.pensionspolicyinstitute.org.uk/media/3263/20190911-pension-charging-structures-and-beyond.pdf

67. We recently ran a consultation on draft regulations, which would allow schemes to smooth the incurrence of performance fees, which are often payable on illiquid investments, over five years. This measure should encourage more trustees to invest in illiquid investments. This consultation also covers relevant amendments to the 2015 Regulations, which we plan to implement in October 2021, subject to the outcome of the consultation.

68. The Government is seeking to offer DC schemes greater flexibility to accommodate performance fees within the charge cap. Clearly this has ramifications for the effect of standardising charges regimes where different approaches to one element of charges is introduced which we will consider, depending on the outcome of this consultation and *'Incorporating performance fees within the charge cap'*.

69. We are aware that the proposal for a universal charging structure, if implemented, may significantly impact some sectors of the automatic enrolment market, and we will need to take time to carefully consider your responses., Subject to consideration of the consultation responses, there will be a further opportunity to comment on any detailed proposals for legislation. We will, therefore, continue to take forward the proposal referred to above.

70. Once a final decision on progressing towards a universal charging structure is made, we intend to conduct a regulatory impact assessment prior to introducing the legislation, and will seek to draw out the costs and benefits of the proposal.

The role of the Employer

71. It is the employer who will select the scheme into which their employees are enrolled, whilst the employee, may if they wish select the individual fund into which their contributions are invest. Although we have described above that few employees take this step, and they are therefore automatically enrolled in the chosen provider's default fund.

72. Employers could pay their own fee to the pension scheme provider for joining their scheme and are required by law to contribute to their employee's automatic enrolment pension by a minimum of 3% of the employee's gross salary. We would like to better understand employers' policies toward paying a contribution towards employees' pensions, where an employee may wish to switch to an alternative fund within the same provider or switch to an entirely new provider. Employers are under no legal obligation to continue to pay a contribution towards a member's pension, should the employee wish to transfer to an alternative product with a different provider, this means there is a risk that the employee could lose the employer contribution, which could far outweigh any impact resulting from paying a lower charge elsewhere.

73. Qualitative research with newly established employers about automatic enrolment found employers typically viewed automatic enrolment as a positive

measure in helping workers save more for retirement, and acknowledged its importance in the context of an ageing society[9]. When it came to looking for information and advice, whatever their level of previous experience, it was rare for employers to engage in extensive information-seeking: they usually sought just enough information to become compliant, and little beyond this.

74. We would welcome your views on the following questions:

Questions

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

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

9 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/896936/automatic-enrolment-qualitative-research-newborn-employers-final-report.pdf

Summary of Questions

Questions

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

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

3. Would proposed implementation in April 2022 create any business or operational challenges?

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

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

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

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

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

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

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

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

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

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

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

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

Annex A: Permitted charging structures within the Charge Cap

Under the Occupational Pension Schemes (Charges and Governance) Regulations 2015 there are three permitted charging structures:

1) a single percentage charge of the pot value, taken at the end of each year and capped at 0.75% of funds under management;
2) a combination of a percentage charged on each new contribution made, plus an annual percentage of funds under management charge;
3) a combination of a monthly or annual flat fee plus an annual percentage of funds under management charge.

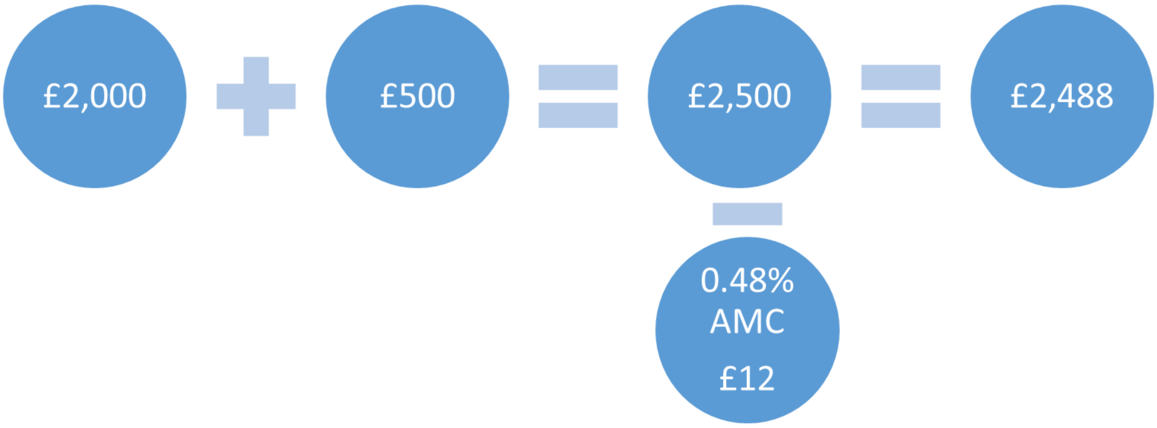
The examples included below are to show how each charging structure works and does not include investment returns or any other ongoing charges outside the charge cap. Each example starts with an initial pot total of £2,000 which includes any previous contributions, investment growth and charges. Then we consider the impact of the three charging structures on this pot if a member contributed £500 over a year.

The example charges used in these illustrations are reflective of the sorts of charges seen across the industry.

Charging Structure 1: A single percentage charge – capped at 0.75% of funds under management

A single percentage charge is when providers **take a percentage of the pot value** at the end of the year.

For example, a member has £2,000 in their pension pot after previous contributions, investment growth and charges. They then contribute £500 to that pot over the next year. At the end of the year £2,500 is in their pot. The provider takes 0.48% from the £2,500 pot. This is £12. The new pot total after charges is £2,488, before investment growth is factored in.



This type of charge can benefit newer members and those with smaller pension pots, versus other types of charges. This type of charge is costlier to those with larger pots.

This type of charge is most economical for providers who want to offer flexible pricing or investment strategies. It is not as cost effective for new providers, with much lower assets under management.

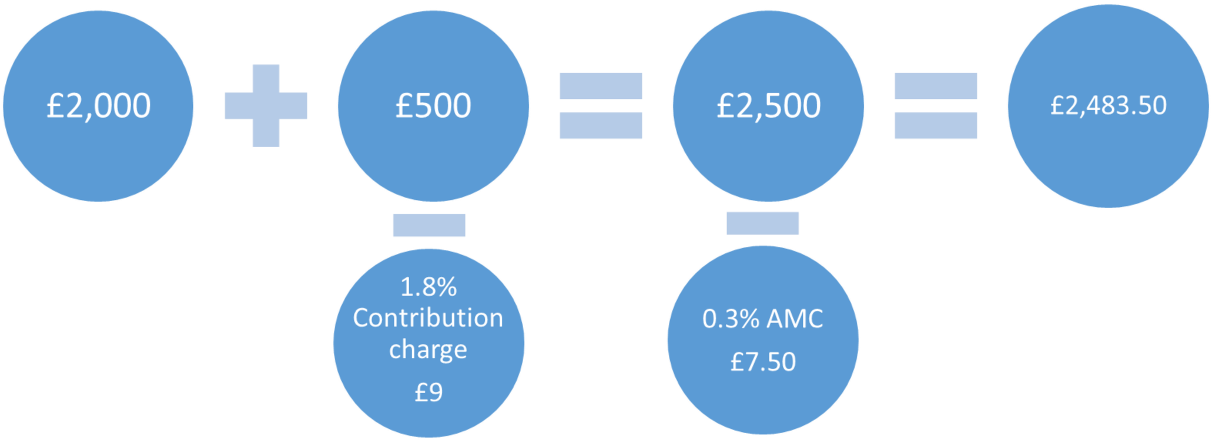
Charging Structure 2: A combination of a contribution charge plus a percentage of funds under management charge

Permissible maximum charge combinations are shown in the table below

Contribution percentage charge rate (%)	Percentage of funds under management rate (%)
1 or lower	0.6
Higher than 1 but no higher than 2 0	0.5
Higher than 2 but no higher than 2.5	0.4

A contribution charge is when providers **take a percentage off each contribution** into the pot. Then the provider also takes **a percentage of the total pot value** at the end of the year.

For example, a member has £2,000 in their pension pot after previous contributions, investment growth and charges. They then contribute £500 to that pot over the next year. The provider takes 1.8% from the £500 contributed to the pot. This is £9. The provider also takes 0.3% from the new pot total after contributions, which is £2,500. This is £7.50. The total charge is £16.50. The new pot total after charges, but before investment growth, is £2,483.50.



This type of charge is best for providers who need to access charge income quickly. This may be newer providers who are building up their assets or are paying back set up fees or loans.

This type of charge is most economical for members with a low level of pension saving. This also includes deferred members as they would not be charged the contribution charge. The percentage charge is usually lower when levied with a contribution charge, therefore deferred members may be charged less in this structure than a single percentage charge or flat fee structure.

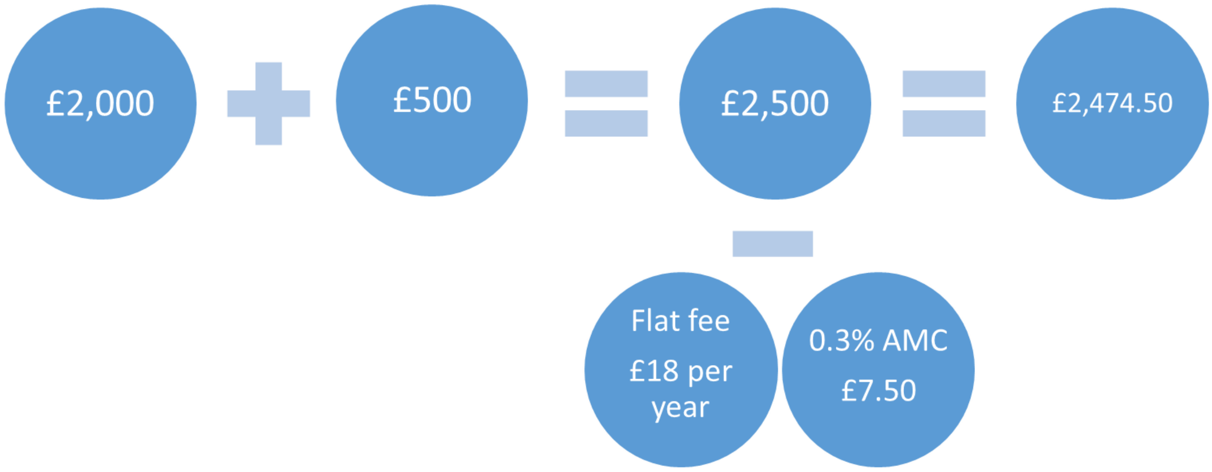
Charging Structure 3: A combination of a flat fee plus a percentage of funds under management charge

Permissible maximum charge combinations are below

Flat fee charge (£ per year)	Percentage of funds under management rate (%)
10 or less	0.6
More than 10 but no more than 20	0.5
More than 20 but no more than 25	0.4

A flat fee charge is when providers **take a fixed charge from a pension pot**. Then providers also take a **percentage of the total pot value** at the end of the year. The member is charged the fixed fee and percentage charge even if they are not actively contributing to their pension.

For example, a member has £2,000 in their pension pot after previous contributions, investment growth and charges. They then contribute £500 to that pot over the next year. The provider takes a flat fee of £18 from the pot total. The provider also takes 0.3% from the pot total, which is £2,500. This is £7.50. The total charge is £25.50. The new pot total after charges is £2,474.50, before investment growth is factored in.



This type of charge is most economical for providers who have smaller assets under management, lots of small pots or members who are lower earners. The providers who use flat fees will be subject to the £100 de minimis on the use of these fees, once this policy is implemented. This type of charge is most economical for members with larger pots as there is generally lower levels of cross subsidy than with the other charging structures.

<u>'Real life' examples of each charging structure</u>

We can look at the impact the three charging structures have on the pot size of different members over one year. In these examples the single percentage charge used is 0.48%, which was the average charge from the Pension Charges Survey 2020. We can see the impact charging has after 1 year on three different employees; Sally, Hannah and Tim.

<u>Sally</u>

Sally does not have a pension pot. She starts a new job, earns £20,000 and is auto-enrolled. She pays £600 in pension contributions over 1 year. She benefits most from a single percentage charge structure. For someone like Sally, with no or a small pot and moderate contributions a single percentage charge is their most economical option.

<u>Hannah</u>

Hannah has been contributing to her pension for 10 years and has built up a pension pot worth £10,000. She earns £20,000 and is auto-enrolled. She pays £600 in pension contributions over 1 year. She benefits most from the contribution charge plus a percentage of funds under management charge. For someone like Hannah, with an established pot and moderate contributions, a contribution charge plus a percentage of funds under management charge is their most economical option.

Tim

Finally, Tim has been contributing to his pension for 10 years and has built up a pension pot worth £10,000. He earns £40,000 and is auto-enrolled. He pays £1,200 in pension contributions over 1 year. He benefits most from the flat fee plus a percentage of funds under management charge. For someone like Tim, with an established pot and high contributions a flat fee plus a percentage of funds under management charge is their most economical option.

Sally's pension pot under each charging structure:

Charging structure	Current pot total	Contributions after 1 year	New pot total	Charge total	Pot total after charges
0.48% AMC	£0	£600	£600	£2.88	£597.12
0.3% AMC and 1.8% contribution charge	£0	£600	£600	£12.60	£587.40
0.3% AMC and £18 per year flat fee	£0	£600	£600	£19.80	£580.20

Hannah's pension pot under each charging structure:

Charging structure	Current pot total	Contributions after 1 year	New pot total	Charge total	Pot total after charges
0.48% AMC	£10,000	£600	£10,600	£50.88	£10,549.12
0.3% AMC and 1.8% contribution charge	£10,000	£600	£10,600	£42.60	£10,557.40
0.3% AMC and £18 per year flat fee	£10,000	£600	£10,600	£49.80	£10,550.20

Tim's pension pot under each charging structure:

Charging structure	Current pot total	Contributions after 1 year	New pot total	Charge total	Pot total after charges
0.48% AMC	£10,000	£1,200	£11,200	£53.76	£11,146.24

0.3% AMC and 1.8% contribution charge	£10,000	£1,200	£11,200	£55.20	£11,144.80
0.3% AMC and £18 per year flat fee	£10,000	£1,200	£11,200	£51.60	£11,148.40

Annex B: Illustrative de minimis examples

There are two illustrative examples of how the de minimis will work in practice for flat fees levied monthly or annually. The second example considers how to manage the annual percentage charge and flat fees when they are payable in the same month.

Example 1: In a month where only the flat fee is payable:

a) The flat fee can be applied as long as the pot has a value of £100.01 or above. For example, Pot 1 is worth less than £100.01 so a flat fee cannot be applied.

b) In instances where applying the full flat fee would decrease a pot to below £100, a partial flat fee can be applied. For example, Pot 2 is worth £100.01 so only a partial flat fee of £0.01 can be applied.

c) For any other pots over £100.01, the full flat fee can be applied as normal. For example, Pot 3 is worth £110.00 so a full flat fee can be applied.

	Pot value	De minimis	Flat fee (£1.50 per month)	New pot total after monthly flat fee
Pot 1	£100.00	De minimis applied	N/A	£100.00
Pot 2	£100.01	N/A	£0.01	£100.00
Pot 3	£110.00	N/A	£1.50	£108.50

Example 2: In a month where both the annual percentage charge and flat fee is payable:

a) The annual percentage charge should be applied to the pot first. This can be applied to all pots regardless of size.

b) If a pot is worth £100.01 or more after the annual percentage charge has been applied, the flat fee can also be applied. For example, Pot 1 is worth less than £100.01 so a flat fee cannot be applied. For Pot 2 even though it starts off at £100.25 it is worth less than £100.01 after the annual percentage charge has been applied, so a flat fee cannot be applied.

c) In instances where after applying the annual percentage charge, applying the full flat fee would then decrease a pot to below £100, only a partial flat fee can be applied. For example, Pot 3 is worth £100.70 after the annual percentage charge so a partial flat fee of only £0.70 can be applied.

d) For any other pots over £100.01, after applying the annual percentage charge, the full flat fee can be applied as normal. For example, Pot 4 is worth £109.67 after the annual percentage charge has been applied so a full flat fee can be applied.

	Pot value	Annual percentage charge (0.3%)	Pot total after annual percentage charge	De minimis	Flat fee (£1.50)	Total charge	New pot total after percentage charge and flat fee
Pot 1	£100.00	£0.30	£99.70	De minimis applied	N/A	£0.30	£99.70
Pot 2	£100.25	£0.30	£99.95	De minimis applied	N/A	£0.30	£99.95
Pot 3	£101.00	£0.30	£100.70	N/A	£0.70	£1.00	£100.00
Pot 4	£110.00	£0.33	£109.67	N/A	£1.50	£1.83	£108.17