Research Summary

Landscape and Charges Survey 2013: Charges and quality in defined contribution pension schemes

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Introduction

This report provides the findings of a study commissioned by the Department for Work and Pensions (DWP), designed to explore charging levels and structures in trust- and contract-based pension schemes and to understand the characteristics of schemes that maximise the chance of better outcomes for members.

Background

The Government is taking action to help support existing pension provision in light of automatic enrolment, and has made a commitment to monitor its possible impacts. As part of DWP's ongoing workplace pension reform research programme, this study was designed to examine charges and quality in trust- and contract-based workplace pension schemes.

Scope of the research

The research comprised a combination of quantitative research with private sector employers offering a defined contribution (DC) workplace pension, supplemented by qualitative and administrative data supplied by providers and other industry participants. The charges survey was split into three parallel elements:

- **trust-based DC schemes**: 593 telephone interviews with trust-based schemes with six or more members, which are open to new members, and where the employer makes a contribution;
- **contract-based schemes**: 717 telephone interviews with contract-based schemes with six or more members, which are open to new members, and where the employer makes a contribution;
- **contract-based pension providers**: Qualitative interviews with 11 of the top 20 contract-based pension scheme providers in terms of market share.

The same robust survey methodology has been used as in DWP's 2011 Charges survey[1], which has allowed us to examine how charging levels have changed since 2011.

In addition, to explore the subject of pension scheme quality, and the characteristics that maximise the likelihood of better outcomes for members, qualitative interviews and focus groups were conducted with the 11 pension providers that took part in the Charges survey, as well as 14 intermediaries of all sizes.

[1] Wood, A., Wintersgill, D. and Baker, N. (2012). *Pension landscape and charging: Quantitative and qualitative research with employers and pension providers*, Department for Work and Pensions. Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193451/rrep804.pdf

Key findings

Charges paid by scheme members

In most DC pension schemes, members are required to pay an annual management charge (AMC), which covers the costs that the pension provider incurs in setting up and running the pension scheme, and in some cases, commission paid to an intermediary.

The most common approach to charging was where members paid a fixed percentage of their total pension fund to the provider per year. The average AMC for trust-based schemes was 0.75 per cent of the fund per year; this had not changed significantly since 2011, when the AMC was reported as 0.71 per cent overall. Among contract-based schemes the average AMC had fallen slightly from 0.95 per cent in 2011 to 0.84 per cent in 2013.

The key determinants of the AMC were:

- **size of the scheme**: Members of smaller schemes (12 to 99 members) paid a higher than average AMC in both trust-based and contract-based schemes, of 0.91 per cent. In contrast, members of larger schemes (1,000 members or more) paid an average of only 0.42 per cent in trust-based and 0.51 per cent in contract-based schemes;
- **commission**: Where a commission-based adviser was used, this led to an average increase in the AMC paid by members of trust-based schemes of 0.4 percentage points; and in contract-based schemes of just under 0.2 percentage points;
- **contributions**: Higher contributions led to a lower AMC being paid by members;
- **scheme age**: Older schemes tended to charge more.

Fees paid for advice and other services

Two-thirds (64 per cent) of trust-based schemes reported that they had used an adviser in relation to their scheme in the past year. Their likelihood of having done so increased with scheme size: 85 per cent of trust-based schemes with 1,000 members or more reported using an adviser, compared to only 44 per cent of the smallest schemes.

Where employers with a trust-based scheme paid a fee for advice, this was £180 per active member on average, while those with contract-based schemes paid £140 on average. Larger schemes paid less on a per member basis, and almost all employers claimed that such fees were never passed onto members.

Active Member Discounts

Some providers offered lower AMCs to members currently contributing to the scheme (active members) than to members no longer making contributions (deferred members). Three per cent of trust-based and ten per cent of contract-based schemes reported using such Active Member Discounts (AMDs), charging deferred members an average of 0.38 per cent more.

Additional charges for specific funds

While providers typically set the basic AMC, normally paid by the majority of a scheme's members, there were circumstances under which some members of a particular scheme might pay higher charges than others.

Most commonly this happened where a member chose to invest in certain funds other than the default fund. The vast majority of contract-based pensions and two-thirds of trust-based schemes offered members a choice of funds, although providers pointed out that between 80 and 95 per cent of members of contract-based schemes were invested in a default fund.

The relationship between charges and scheme quality

In our interviews with providers and advisers, most agreed that high charges could have a major impact on member outcomes over the lifetime of a pension. However, most providers insisted that charges on new schemes were now at an historic low and argued against lowering them further, except on older schemes with very high charges. Providers felt that higher charges sometimes allowed them to offer a range of higher quality services, which could help drive member engagement, for example, by spending more money on high-quality communications.

Some advisers agreed that there was more to picking an appropriate scheme than simply identifying the one with the lowest charges. Advisers did not agree on a specific list of services for which it was worth paying more, but explained in broad terms that they would recommend a higher-priced scheme if they felt that it was better suited to the employer's and members' individual objectives.

Many advisers (and providers) felt, however, that providers' charging structures could be too complex and inconsistent for them to perform this task effectively, and that this could be a barrier to fostering transparency and trust in the industry. They suggested that creating a straightforward way to compare charges across providers would help to achieve this goal.

Some also questioned the fairness of AMDs. A number of advisers reported that members were not always aware that their charges could go up if they left their employer, and considered this kind of discount to be increasingly problematic, given that there was a growing trend for people to change employers multiple times during their working life.

Charges and employer size

Providers and intermediaries agreed that charges depended heavily on the size of the employer, with members at larger employers usually benefiting from lower charges, due to the economies of scale associated with processing a larger membership.

Providers and intermediaries disagreed as to whether master trusts or Group Personal Pensions (GPPs) offered members at smaller employers better value for money. Several master trusts offered members a flat-rate AMC regardless of employer size and were, therefore, perceived to be an attractive option for smaller employers. However, some master trusts did charge members at smaller employers more, reportedly because the provider incurred fixed costs in setting up a new employer to use the master trust, and in providing trust-based governance.

Scheme governance

Providers and intermediaries felt that it was crucial for trustees to have the appropriate level of skill and engagement to govern schemes effectively. Many felt that employer-based trustees were likely to scrutinise their own scheme's structure and performance on a continuous basis, as well as nurture member engagement with the pension scheme.

Nevertheless, some providers were concerned that there was not sufficient regulation of trust-based schemes, and felt that some trustees, particularly those governing smaller schemes, could lack the necessary skills to do so. Master trusts were, therefore, perceived as a good alternative for smaller employers, offering the high quality governance of a large provider, which a small employer might not otherwise be in the position to afford.

GPP providers reported that they governed their own scheme via one or more internal committees, which would sometimes contain one or two independent members. Some providers insisted that the schemes they actively marketed offered levels of governance that were as good as those of trust-based schemes, benefiting both from their professional expertise and guided by the Financial Conduct Authority's (FCA's) Treating Customers Fairly (TCF) principles.

Others noted, however, that older contract-based schemes that had been set up several years in the past and were no longer open to new members would often be reviewed by providers less frequently, potentially not benefiting from the same level of systematic and regular governance. This was despite the fact that the TCF principles also applied to these older schemes.

Investment governance and default options

Both providers and intermediaries felt that it was vital to design an investment strategy that was appropriate for the membership profile. Most default options actively marketed by providers now were seen as a safe and appropriate approach for most members, and were heavily influenced by DWP's default option guidance.

The majority recommended that those governing the default fund should meet at least quarterly to assess investment performance, and review the overall scheme objectives at least every three years; but warned against reacting over-sensitively to market fluctuations.

Traditional and master trusts were seen to offer a particular regulatory advantage over contract-based schemes: trustees could take the decision to move members out of a particular default fund if this was deemed to be in members' best interests; whereas in a contract-based scheme, this could not be done without the member's permission.

Scheme administration

Advisers underlined the importance of good administration in driving positive member outcomes. Most providers were confident that their own administration processes were effective. However, Employee Benefits Consultants and Independent Financial Advisers felt that certain providers that used paper-based processes, particularly when receiving membership data, could often suffer from data entry errors. They singled out providers whose schemes were closed to new business as committing this kind of error more frequently.

The majority warned that poor communication with employers or members could also have an impact on administrative data, with such mistakes in administration potentially undermining a provider's ability to communicate and build trust with the member. Conversely, several providers felt that administrative errors were often the result of employers failing to give them complete and up-to-date information.

Almost all agreed, however, that increased use of electronic data processing had meant that such issues were becoming rarer, and had improved transparency and communication with members.

The full report of these research findings is published by the Department for Work and Pensions (ISBN 978 1 909532 99 1. Research Report 859. February 2014).

You can download the full report free from: http://research.dwp.gov.uk/asd/asd5/rrs-index.asp

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