

Regulatory Policy Committee		Opinion	
Impact Assessment (IA)		Charges in Qualifying Pension Schemes	
Lead Department/Agency		Department for Work and Pensions	
Stage		Consultation	
IA Number		DWP0042	
Origin		Domestic	
Expected date of implementation (and SNR number)		SNR7	
Date submitted to RPC		04/11/2013	
RPC Opinion date and reference		05/12/2013	RPC13-DWP-1950
Overall Assessment		RED	
RPC comments			
<p>The IA is not fit for purpose. In particular, the evidence presented does not adequately demonstrate why Option 3 is considered to have a zero net impact on the pensions industry. In addition, robust estimates for all options need to be presented, so that consultees, and ultimately the final policy decision, are informed effectively.</p>			
Background (extracts from IA)			
What is the problem under consideration? Why is government intervention necessary?			
<p>“Individuals saving into a pension scheme generally incur charges, usually levied as a percentage of their fund... However, information on charges is not always clearly disclosed and employers – who choose the workplace pension scheme their employees pay into - are often unaware of the charges their employees pay. Furthermore, it may not often be their key concern when selecting a pension scheme. With automatic enrolment projected to result in 6-9 million people newly saving or saving more into a pension, and those saving through automatic enrolment having little choice over the scheme they save into, it is important that individuals are protected against excessively high charges.”</p>			
What are the policy objectives and the intended effects?			
<p>“To protect individuals from incurring excessively high charges on their retirement savings, particularly where they have not made an active decision on their scheme, and through this to ensure the long-term success of the Government’s reforms to help people secure an adequate income in their retirement.”</p>			
What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)			
<p>Three options have been considered in this IA – 1) do nothing; 2) improve disclosure of pension scheme charges 3) set a charge cap on the default fund in qualifying pension schemes which are used for the purposes of automatic enrolment.</p>			
Identification of costs and benefits, and the impacts on business, civil society organisations, the public sector and individuals, and reflection of these in the			

choice of options

Impact on pension providers. The IA discusses potential reasons why a number of pension providers are currently able to levy higher annual management charges (AMC) and yet remain competitive. These include employers expressing “a preference for a simple solution that is easy to implement” (paragraph 23); the “principal agent problem - whereby the employer ‘buys the pension scheme, but the individual is the end ‘customer’ – is confounded by the fact most employers do not know what charges their members pay” (paragraph 25); lack of transparency in the information supplied by pension providers resulting in an information asymmetry (paragraph 27) etc.

Given the principal -agent problem and information asymmetries described in the IA, it would appear that some pension providers may be making excessive profits which are considerably above the expected norm. If this is the case then Option 3, which proposes the introduction of a charge cap on default funds in qualifying pension schemes, will result in a profit reduction for many of these firms. The evidence, as it is currently presented in the IA, does not adequately demonstrate why Option 3 is considered to have a zero net impact on the pensions industry.

Costs of Option 2. We note that Option 2, which requires an increased disclosure of information by pension providers, is expected to cost the industry £172 million, whereas Option 3, an industry wide charge cap in qualifying pension schemes, is only expected to cost the industry £19 million. In relation to the costing of Option 2 the IA says that “ongoing administrative costs are likely to be over-estimated, as many providers plan to voluntarily send out information on charges. The estimated cost of sending out information is also based on paper-based communications - providers have the opportunity to disclose information to employers and individuals through electronic communications, which should reduce costs. Costs will also be lower for schemes choosing to adapt existing communications rather than sending out new additional information”(page 3). This suggests that the IA’s estimates are significantly overstated in Option 2. It is very important that robust estimates are provided for all the options so that consultees are properly informed.

Identification of all potential costs. There are a number of potential costs that do not appear to have been identified within the IA. For example, Option 3 is currently assessed as only having a transition cost but given that it will require employers to ensure that the scheme they choose is in line with the proposed price cap, it is likely that pension providers will incur some on-going costs from providing the required information on charges. Also, given that the majority of pension charges are currently at or below 1%, a possible effect of a charge cap would be that providers charging less than this cap would tend to increase their charges to the level of the cap without losing customers. The likelihood and impact of this outcome should be explored in more detail.

Presentation of costs. The transitional costs to businesses for setting up alternative pension provision (Table 5) have not been adequately evidenced. It is not clear what the cost per employer is or how this has been derived. The IA should present this information clearly to ensure that the estimates and assumptions can be tested effectively through consultation.

Consideration of options. Given that Option 2 and 3 appear to result in different benefits i.e. Option 2 will improve transparency and disclosure of charges, while Option 3 will introduce of a charge cap, it is unclear why a combination of Options 2 and 3 has not been discussed.

While the IA says that Option 2 may not meet Government's objective because *"giving extra information to employers or individuals may not by itself be sufficient to meet the Government's objective of ensuring that individuals do not incur excessive charges"* (paragraph 58), it is unclear how Option 3 will address the problems of lack of awareness and lack of transparency in the information supplied by pension providers. As stated at paragraph 29 there is *"a strong rationale for Government to address both the principal-agent problem and informational asymmetries outlined above"*. The costs of Option 3 do not indicate that the pension industry will be required to provide additional information on charges. Therefore, the IA could have provided an explanation as to why the potential option of improved transparency coupled with the introduction of a charge cap has not been considered.

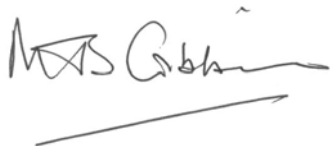
Comments on the robustness of the Small & Micro Business Assessment (SaMBA)

The IA provides adequate discussion on the implications of the proposed changes for Small & Micro Businesses where provision has been made for alleviating the impacts. We note in particular that *"by setting up a low-cost pension scheme in the form of NEST, the Government have minimized the cost which these employers will incur in having to find alternative pension provision for their employees"* (paragraph 125). We also note the other 'easements' for smaller employers, for example where they won't have to enrol their workers until June 2015 at the earliest (for those with fewer than 50 employees)

Comments on the robustness of the OITO assessment.

The IA says that this is a regulatory proposal that is in scope of OITO and would impose a direct net cost to business (an 'IN'). Based on the evidence presented this assessment appears reasonable and is consistent with the current Better Regulation Framework Manual (paragraph 1.9.10). The evidence supporting the estimated Equivalent Annual Net Cost to Business will have to be strengthened so that it can be validated at final stage.

Signed



Michael Gibbons, Chairman