Title: Banning member-borne commission in occupational pension schemes used for automatic enrolment **IA No**:DWP2015_01 **Lead department or agency:** Department for Work and Pensions **Other departments or agencies:**	**Impact Assessment (IA)** **Date:** 15/12/15 **Stage:** Final (Validation) **Source of intervention:** Domestic **Type of measure:** Secondary Legislation **Contact for enquiries:** lorraine.pearson1@dwp.gsi.gov.uk
Summary: Intervention and Options	**RPC Opinion: Validated**

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2014 prices)	**In scope of One-In, Three-Out?**	**Measure qualifies as**
£-0.13m	£-10.11m	£1.12m	YES	IN

What is the problem under consideration? Why is government intervention necessary?

Automatic enrolment is designed to increase the number of people saving into a pension. In most cases, employees will be automatically enrolled into a defined-contribution (DC) pension scheme. In 2013 the Office of Fair Trading (OFT) DC market study[1] concluded that competition alone cannot be relied upon to drive value for money in the DC workplace pension market due to weaknesses in the buyer side of the market and the complexity of the product. The lack of transparency of scheme charges creates information asymmetry in the pensions market whereby the employer or scheme member often does not have the information or understanding of what is a good value scheme. Furthermore, there is a principal agent problem in the automatic enrolment market where the employer selects the scheme on behalf of their employees but may not understand or act in the employee's best interests.

One specific feature of the existing market is commission arrangements agreed between a service provider and an adviser, or an employer and an adviser, where the charge is passed on to members who are required to pay for advice and services they do not use or may not benefit from. Therefore there is a risk that employers may automatically enrol employees into poor value pension schemes, and market intervention is necessary to help ensure all individuals automatically enrolled into schemes get value for money. This intervention is designed to increase transparency and fairness of member-borne charges, and maintain confidence in automatic enrolment.

The Government has recently consulted on the most effective way of regulating to ban commission to ensure that the proposed regulations placed requirements on those firms that are best placed to prevent and remove new and existing commission arrangements, without introducing unnecessary burdens on those firms who are not party to commission arrangements.

[1] 'Defined Contribution Workplace Pension Market Study', Office of Fair Trading, September 2013, http://webarchive.nationalarchives.gov.uk/20131101164215/http:/www.oft.gov.uk/shared_oft/market-studies/oft1505

What are the policy objectives and the intended effects?

The policy objective is to prevent members of occupational pensions schemes used for AE from being charged for commission arrangements agreed between third parties, and paying for advice and services they do not use or benefit from. , This will support automatic enrolment and maintain trust and confidence in pension providers. Advisers will still be able to offer and charge for specific advice and services to members and employers - but they will no longer be paid for this via a blanket charge on all members within schemes.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Four policy options have been considered: 1) do nothing; 2) place a duty on trustees requiring them to ensure that members of pension schemes they are managing are not bearing the costs of commission; 3) place a duty on service providers requiring them to prevent and remove new and existing commission arrangements; or 4) place a duty on both trustees and service providers (the preferred option).
The risk that the 9 million members who will be newly saving or saving more as a result of automatic enrolment have the value of their savings eroded by hidden commission charges is too high to do nothing.
..
Following consultation, the Government's preferred approach is option 4, which places requirements on both trustees and service providers. This is because service providers are best placed to prevent commission; but the provider and the trustee hold different pieces of information which need to be shared in order for the ban to be effective. Under option 2 service providers may not know which schemes relate to automatic enrolment, and under option 3 trustees may not know whether the scheme contains commission.

Alternatives to regulation have not been considered, given that previous non-legislative approaches have had limited effect.

Will the policy be reviewed? No **If applicable, set review date:** N/A

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** YES	**< 20** YES	**Small** YES	**Medium** YES	**Large** YES
What is the CO2 equivalent change in greenhouse gas emissions? (Million tonnes CO2 equivalent)			**Traded:** N/A		**Non-traded:** N/A

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: [signed by Ros Altman, Minister for Pensions] Date: 21/12/15

Summary: Analysis & Evidence — Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2015	PV Base Year 2016	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low:	**High:**	**Best Estimate:** -0.13

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.0		0.0	**0.0**
High	0.0		0.0	**0.0**
Best Estimate	0.1		1.2	**10.1**

Description and scale of key monetised costs by 'main affected groups'

We estimate one-off familiarisation costs for service providers, trustees and financial advisers totalling £85,000. There is also a one-off administrative cost of £45,000 for service providers who need to remove existing commission arrangements. We estimate a maximum cost of £1.16m loss to the adviser industry per year from the ban on existing commission arrangements.

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition, constant Price)	Total Benefit (Present Value)
Low	0.0		0.0	**0.0**
High	0.0		0.0	**0.0**
Best Estimate	0.0		1.2	**10.0**

Description and scale of key monetised benefits by 'main affected groups'

We estimate a maximum benefit to all members of £1.16m per year if providers reduce their charges in line with the loss to advisers following the removal of existing commission.

Other key non-monetised benefits by 'main affected groups'

There is a possible benefit to scheme members in the form of competition gains from moving towards upfront fees in the advice market, but no evidence is available to test this hypothesis or quantify the impact.

Key assumptions/sensitivities/risks — **Discount rate** 3.5%

The estimates use the standard Green Book discount rate and latest economic assumptions. The estimated loss to advisers and corresponding benefit to members of £1.16m will be an overestimate because it assumes that there will be no transfer of business between advisers and no re-negotiation of contracts by advisers for members to opt in to pay for services. At this stage we do not have data on the likely market response so have used a maximum estimate. The benefit to members may also be an overestimate as providers do not have to reduce charges.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of	Measure qualifies
Costs: 1.1	**Benefits:** 0.0	**Net:** -1.1	YES	IN

Evidence Base

Background

1. In the current market, financial advisers and service providers are able to agree commission arrangements where the financial adviser is remunerated for their services via an administration charge levied on all members of a pension scheme. The service provider administers the member charge, and members bear the cost.
2. There are three forms of commission arrangements:
   - initial commission: this refers to an arrangement whereby a pension provider makes an up-front lump sum payment to an adviser in return for new business; the costs are recovered via a charge borne by scheme members
   - deferred commission: this refers to an arrangement whereby a pension provider agrees a lump sum payment with an adviser and makes the payments, for example, over 2-3 years once a scheme has been established; the costs are recovered via a charge borne by scheme members
   - trail commission: this refers to an arrangement whereby on-going payments are borne by scheme members for advice or services provided by an adviser

Market failure – the case for intervention

3. The 2013 OFT market study[2] looked at the market for defined contribution workplace pension scheme provision and concluded that this market may not deliver value for money outcomes for scheme members.
4. The report found that members could pay commission without realising; and that commission presented a barrier to employers switching their workers to better value for money schemes (because advisers may not recommend a change that would cut off their commission stream).
5. There is a risk that as AE rolls out, the 9 million people who will be newly saving or saving more could be at risk of being enrolled, or are already enrolled, into schemes that include commission. There are two main structural weaknesses of this charging model:

   a. **Principal-agent problem:** Scheme members rely on employers to select a workplace scheme into which they are enrolled and their respective interests and incentives are often different[3], and;

   b. **Information asymmetry:** trustees who seek to maximise benefits for members may not be involved in the transactions that impose the commission fee and in many cases are not aware of the additional cost being borne by members or the benefits of moving to a scheme without commission.

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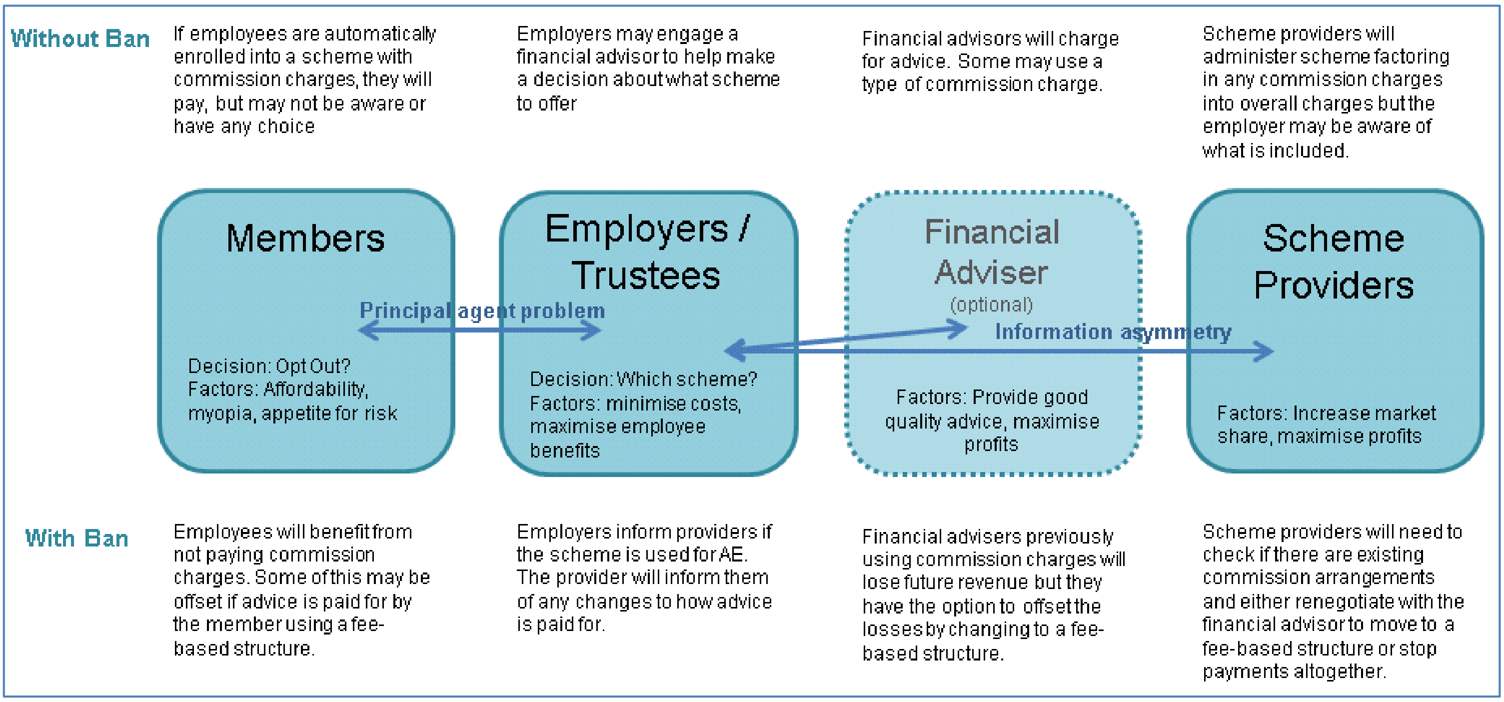
[2] 'Defined Contribution Workplace Pension Market Study', Office of Fair Trading, September 2013, http://webarchive.nationalarchives.gov.uk/20131101164215/http:/www.oft.gov.uk/shared_oft/market-studies/oft1505

[3] More information on the principal-agent problem can be found in the Charges in Qualifying Pension Schemes Impact Assessment, DWP, 2014: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/311363/pensions-act-ia-annex-g-charges-in-qualifying-pension-schemes.pdf

6. The way in which the market currently works with commission in place and the scope of market failure is illustrated in Figure 1, along with the way in which the market will work following the introduction of the ban.

Figure 1: commission process and expected outcomes following the ban



Policy Landscape

7. Since 2012 there have been a number of relevant interventions in the workplace pensions market, summarised by the figure below.

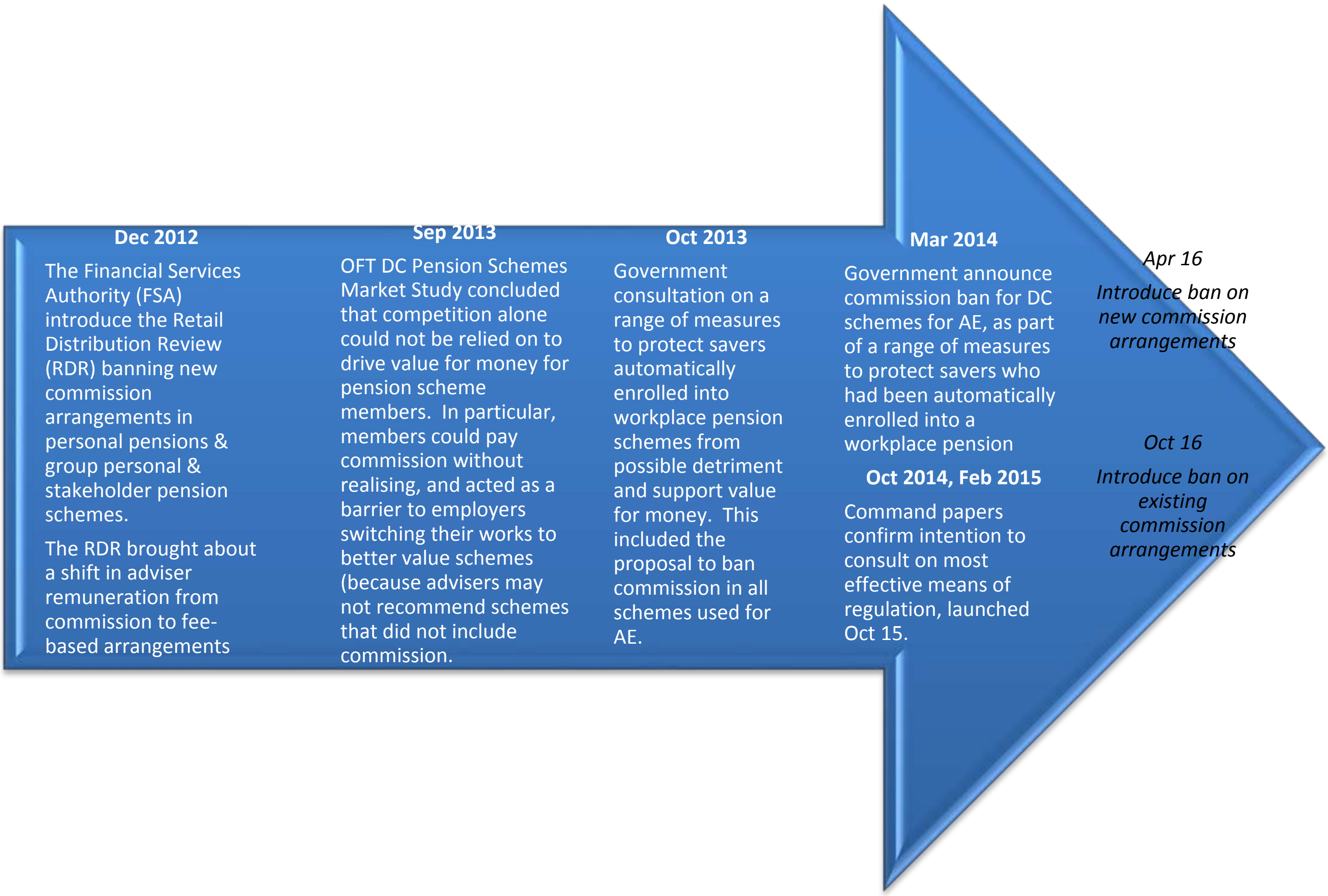
Figure 2: timeline of policy interventions[4][5][6][7]

[4]'Better Workplace Pensions: further measures for savers', DWP, 27 March 2014, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298436/better-workplace-pensions-march-2014.pdf

[5] 'Retail Distribution Review', Financial Conduct Authority, http://www.fca.org.uk/firms/firm-types/sole-advisors/rdr

[6] 'Defined Contribution Workplace Pension Market Study', Office of Fair Trading, September 2013, http://webarchive.nationalarchives.gov.uk/20131101164215/http:/www.oft.gov.uk/shared_oft/market-studies/oft1505

[7] 'Better Workplace Pensions: a consultation on charging', DWP, October 2013, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/254332/cm8737-pension-charges.pdf



Current market context

8. Evidence from the DWP Pension Charges Survey 2015[8] shows that commission is charged in a very small minority of trust-based pension schemes used for AE. Only two of twelve providers interviewed in the 2015 survey reported paying trail commission in trust-based schemes used for AE. These two providers confirmed that these arrangements related to only seven employers (just 1% of the 535 employers with single trust-based schemes used for AE covered by the survey).
9. This reflects the impact of the 2012 RDR on the adviser market, which has subsequently moved from commission-based remuneration to fee-based remuneration. A survey of advisory firms conducted by FundsNetwork found that 80 of 89 firms polled believed that they were either ‘somewhat’ or ‘very’ confident that they will have moved all existing clients from commission to fee-based arrangements by April 2016; and 63% confirmed that they had already moved existing clients from commission to fee-based arrangements. Although this survey was conducted in relation to rules made by the Financial Conduct Authority (as opposed to the proposed DWP regulations) this demonstrates that advisers have or are already transitioning to fee-based arrangements.

[8] DWP Pension Charges Survey 2015: https://www.gov.uk/government/publications/pension-charges-survey-2015-charges-in-defined-contribution-pension-schemes

10. This is important as the Government intends to ban commission while enabling advisers to receive payment via a fixed-fee. This is also reflected in responses we have received from industry stakeholders following the Government's consultation on banning commission in occupational pension schemes used for AE. For example, some of the advisers we spoke to confirmed that they already wholly operated on a fee-basis; others advised that they had already begun to transition from commission to fee based arrangements following the RDR and the announcement of FCA rules (which will come into effect from April 2016).

Policy objective

11. The policy objective is to prevent members of occupational schemes used for AE from being charged for commission arrangements agreed between third parties, and paying for advice and services they do not use or benefit from. This will support automatic enrolment and maintain trust and confidence in pension saving. Advisers will still be able to offer and charge via a fee for specific advice and services to members and employers - but they will no longer be paid for this via a blanket charge on all members within schemes.

Description of options considered

12. Following the consultation, the Government's preferred option is to place duties on both trustees and service providers. The analysis for this impact assessment estimates the cost and benefits of this preferred option against the counterfactual (do nothing).
13. As part of the compliance and enforcement process, trustees will also have to confirm in their scheme return that members are not paying for commission. The scheme return is an existing process managed by TPR. Trustees are already obliged to confirm adherence to other charges control measures, including the charge cap, via the scheme return.
14. The Government intends to implement the ban in two stages:
    - from April 2016 – a ban on new commission arrangements; and
    - from October 2016 – a ban on existing commission arrangements
15. A phased implementation of the ban will help to ensure that workers of employers who will be staging as a result of AE from April 2016 onwards will be protected by the ban on new arrangements; while providing additional time for the Government to prepare and consult on regulations for banning existing commission arrangements, given the complexities involved in this.
16. The Government will consult on draft regulations banning new commission arrangements in early 2016, followed by a consultation on draft regulations banning existing commission arrangements later in 2016. This final stage validation impact assessment quantifies the costs and benefits of both stages of the ban.

Evidence sources

17. The main sources of available evidence on the prevalence of member-borne commission arrangements are the DWP Landscape and Charges Survey 2013 and the DWP Pension Charges Survey 2015.
18. In the 2013 survey, employers reported commission arrangements (grouping together all types of commission) for 25% of their defined contribution trust-based schemes. However, there was substantial variation in the reported prevalence of commission arrangements according to scheme age (33% for schemes established prior to 1991, 19% for those established from 2001 onwards) and charge level (35% for those with average annual charges above 0.75%, 14% for those with average annual charges at or below 0.75%).
19. The 2013 survey did not distinguish between schemes used for AE and those not used for AE, since only the largest employers had started staging into AE at the time of survey in April-May

2013. However, the survey evidence suggests that those schemes with commission arrangements present were older and higher charging schemes, which would be less likely to qualify for use as AE schemes as employers began their staging.

20. This is supported by evidence from the more recent DWP Pension Charges Survey 2015, which does distinguish between whether or not schemes are being used for AE. The 2015 survey interviewed 12 providers of pension schemes, including 8 of the top 10 based on market share. Since providers are directly involved in commission arrangements, they are better placed to report on prevalence than the employers interviewed in the 2013 charges survey.
21. Providers in the 2015 survey reported no initial/deferred commission via member contribution charges in trust-based schemes used for AE, covering approximately 4.5 million members across master-trust and single trust-based schemes. For these same schemes, trail commission was reported by two of eight providers with single trust-based schemes used for AE (and by none of the nine providers who had master-trusts used for AE). The two providers reporting trail commission estimated that this related to only 7 employers in total (1% of the 535 employers with single trust-based schemes used for AE captured by the survey).

22. To inform our assessment of the costs and benefits to business of the preferred option, we have used evidence from the following sources:

    - The 2015 and 2013 charges surveys set out above;
    - Estimates requested from the 2015 charges survey research contractor on the number of members subject to commission charges based on survey responses and qualitative interviews;
    - Estimates requested from The Pensions Regulator (TPR) on the numbers of service providers affected by the ban, and published TPR estimates on the number of trust-based schemes used for AE;
    - Previous impact assessments, consulted to ensure consistency in our approach.

23. Based on the evidence set out above we calculated our initial assessment of the costs and benefits of the ban, and then used the consultation to gather further evidence. We included a question in the consultation document on the potential impacts of the ban for all affected parties; we held roundtable and one-to-one sessions with stakeholders representing the different parties affected by the ban; and, explicitly tested our assumptions and initial estimates with a number of providers.

24. The evidence gathered during the consultation suggests that:

    - The estimated number of members subject to commission charges, due to existing arrangements, in occupational schemes used for AE is approximately 20,000 members.

    - The average level of commission charge is equivalent to around 0.18% of funds under management. This is a weighted average based on information supplied to us during the consultation from providers who set out the number of their members subject to different commission charge levels.

25. To estimate the potential costs and benefits of the preferred option, we have used the evidence set out above. We do not believe it would be proportionate to commission further research on this topic.

Direct costs and benefits

26. We discuss three types of direct costs and benefits associated with the preferred option:
    - Familiarisation costs;
    - Costs and benefits of the April 2016 ban on new commission arrangements; and
    - Costs and benefits of the October 2016 ban on existing commission arrangements.
27. These are set out for each of the following parties affected by the commission ban: service providers[9], trustees, financial advisers, employers and members.
28. The estimates we present here are in 2015 price terms throughout, with the hourly rates data taken from the most recent available 2015 Annual Survey of Hours and Earnings (ASHE)[10].

[9] On the basis of the responses to recent consultation, we have decided to exclude approximately 200 investment manager firms from the regulations, since investment managers would generally not be able to facilitate the provision of advice and services to members (there are members of the Investment Association).

Familiarisation costs

29. We expect there to be one-off familiarisation costs for service providers and trustees due to the regulatory duties being placed on them, and for financial advisers who are servicing this part of the market and will no longer be remunerated via commission arrangements.
30. The majority of these costs were incurred in the previous parliament. DWP announced the forthcoming commission ban in March 2014[11] as part of a package of measures that would be introduced in a phased approach from 6 April 2015 onwards. The commission ban was planned for April 2016 to allow providers and advisers time to prepare for the ban. DWP re-iterated details of the commission ban in follow-up documents of October 2014[12] and February 2015[13]. Further to this, many of the service providers will be the same parties who are affected by the FCA commission ban[14] for qualifying personal pension schemes, which also comes into effect in April 2016.
31. Both DWP and FCA have consulted on the forthcoming ban, and there is widespread industry awareness with many providers having publicly announced their strategy of preparing for the ban. As just one example, Royal London publicly set out changes they will be making in anticipation of the ban in November 2014 with subsequent follow-up communications in February 2015 and March 2015.[15] DWP have engaged with stakeholders throughout the industry prior to and during the consultation. Providers and advisers confirmed during consultation, and providers reported in the DWP Pension Charges Survey 2015, that they are aware of, and have been making preparations for, the ban. We expect trustees or managers of AE schemes to be aware of the forthcoming ban as it forms part of the wider package of charges measures that they should be aware of as part of their responsibilities in managing their schemes.
32. Since awareness of the commission ban is widespread throughout industry, we expect the familiarisation costs incurred in this parliament to be only those relating to the specific details on the timing and nature of the implementation of the ban, as announced following the consultation. This will involve reading and digesting the consultation response document of approximately 40

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[10] Published 18 November 2015 and available at: http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/index.html

[11] DWP Better workplace pensions: Further measures for savers. March 2014 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298436/better-workplace-pensions-march-2014.pdf and FCA CP14/24 and, FCA Charges in workplace personal pension schemes. October 2014. http://www.fca.org.uk/static/documents/consultation-papers/cp14-24.pdf

[12] DWP Better workplace pensions: Putting savers' interests first. October 2014. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/364567/better-workplace-pensions-putting-savers-interests-first.pdf

[13] DWP Government response to the consultation on Better workplace pensions: Putting savers' interest first. February 2015. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/400864/better-workplace-pensions-putting-savers-interests-first-response.pdf

[14] FCA Final rules for charges in workplace personal pension schemes and feedback on CP14/24. March 2015. https://www.fca.org.uk/your-fca/documents/policy-statements/ps15-05

[15] 'Our charge cap and commission stance', Royal London, 2014, http://adviser.royallondon.com/articles/updates/2014/november/our-charge-cap-and-commission-stance/

pages. Following the approach of the private sector defined benefits transfers IA[16], we estimate it will take 100 minutes to read 40 pages (based on an average reading speed of 300 words per minute) and allow a further 20 minutes to digest the information. This gives a total of two hours work for familiarisation, which will be incurred by all service providers, trustees and financial advisers.

Familiarisation costs - service providers

33. The estimated total number of affected service providers is as follows: 50 administrators for trust-based schemes used for AE and 30 insurers for trust-based schemes used for AE[17]. This gives a total of 80 service providers who are expected to incur any familiarisation costs[18].
34. We estimate the total costs of familiarisation for service providers to be £3,962 based on two hours work at a median hourly rate of £24.77 (including any non-wage costs)[19] for one professional, across 80 providers. This represents a maximum estimate for service providers as in many cases this responsibility will be delegated to their legal advisers who are already paid for ongoing services.

Familiarisation costs – trustees

35. The estimated number of trustees incurring familiarisation costs is 910, based on one trustee for each of the 910 DC trust-based schemes and hybrid schemes used for AE[20] needing to familiarise. We estimate the total familiarisation costs for trustees to be £34,748 based on two hours work for an associate professional at a median hourly rate of £19.10 (including any non-wage costs)[21], across 910 schemes. The hourly rate assumed for a trustee is at the associate professional level, in line with the private sector DB transfers IA[22]. In practice, many trustees are unpaid whilst some may receive higher wages than this, with this figure representing our best estimate of the average trustee hourly rate.

Familiarisation costs - financial advisers

36. We do not have an estimate of the number of financial advisers who have commission arrangements in qualifying, trust-based schemes, although the evidence from the Pension Charges Survey 2015 has shown that such arrangements are uncommon. We make a simplifying

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[16] Amendments to Pension Schemes Bill (private sector defined benefit transfers) IA. IA no: RPC14-HMT-2212. September 2014. http://www.parliament.uk/documents/impact-assessments/IA14-13A.pdf

[17] Estimates of insurers and administrators for trust-based AE schemes provided by The Pensions Regulator (TPR).

[18] This represents a maximum estimate of affected service providers because there could be double-counting of the service providers in the case of bundled schemes.

[19] The estimate of £24.77 is based on the gross median hourly rate for a professional, increased by 27% in line with the Green Book to account for non-wage costs. It is assumed that for both administrators and insurers a single professional employee would undertake this work. The hourly rate data are taken from the Annual Survey of Hours and Earnings (ASHE), 2015: http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip.

[20] The number of DC trust-based and hybrid schemes used for AE is taken from Table 5 of TPR's Automatic Enrolment Commentary and Analysis, 2015 http://www.thepensionsregulator.gov.uk/doc-library/research-analysis.aspx#s16194. The number stated here is higher than that shown in Table 5 because we have apportioned the unknown responses between scheme types. This may be a slight over-estimate as not all hybrid schemes have money-purchase benefits associated with them. We do not expect this estimate to alter significantly in the lead up to the ban in 2016, as the majority of employers automatically enrolling between now and then are likely to use already established schemes.

[21] The estimate of £18.87 is based on the gross median hourly rate for an associate professional, which is increased by 27% in line with the Green Book to account for non-wage costs. The hourly rate data are taken from ASHE, 2014: http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2014-revised-results/rft-2.zip Table 2.5a.

[22] Amendments to Pension Schemes Bill (private sector defined benefit transfers) IA. IA no: RPC14-HMT-2212. September 2014. http://www.parliament.uk/documents/impact-assessments/IA14-13A.pdf

assumption here in estimating that there is one financial adviser for each of the 910 qualifying, DC trust-based and hybrid schemes. This will be an overestimate, as the pensions advice market is more concentrated than this with many schemes receiving advice from the same adviser, rather than there being one distinct adviser per scheme. However, without further evidence, this remains our best estimate producing estimated costs of familiarisation to financial advisers of £45,052 based on two hours work for a professional at a median hourly rate of £24.77 (including non-wage costs) [23] across 910 financial advisers.

Total combined familiarisation costs

37. This gives us a total combined (for service providers, trustees and financial advisers) estimate of one-off familiarisation costs of approximately £85,000.

Costs and benefits of the April 2016 ban on new arrangements

Service providers

38. After accounting for the familiarisation costs set out above, we estimate that the ban on new commission arrangements will have **zero ongoing costs** for service providers. Where service providers have previously relied on advisers to promote their services, and paid for this via member-borne commission, they will need to find alternative ways of promoting the scheme and paying for this service. However, based on the evidence set out in paragraphs 17-21, commission is largely a legacy issue rather than a model that service providers rely on to achieve business in the current AE market. AE has substantially reduced the reliance on intermediaries for new business, with employers now going direct to service providers.
39. As service providers simply make commission payments to advisers (and recover the cost from member charges), rather than retaining them, they should be financially no worse off as a result of being prevented from facilitating these payments in future.

Trustees

40. There will be **zero ongoing costs** to trustees of the ban on new commission arrangements. Trustees are already required under governance regulations to consider whether the costs and charges borne by members represent good value. It should not impose any additional burdens on trustees to confirm that their schemes are commission free via the annual scheme return, which already forms part of their duties. Further, confirming to service providers whether or not the scheme is being used for AE, should be a straightforward process for trustees as they will know this information and could confirm this electronically.
41. We do not expect there to be any issues of non-compliance on the part of service providers for trustees to respond to since: providers do not gain from setting up commission arrangements; evidence suggests that such arrangements are already uncommon; and, not having commission arrangements allows providers to more easily ensure they meet the 0.75% default fund charge cap and retain the significant business they receive from AE.
42. Under the ban on new arrangements, trustees, like employers and members, will still be able to access advice and services provided by an adviser. Any costs and charges will be borne by the trust as before.

Financial advisers

[23] The estimate of £24.77 is based on the gross median hourly rate for a professional, increased by 27% in line with the Green Book to account for non-wage costs. The hourly rate data are taken from the Annual Survey of Hours and Earnings (ASHE), 2015: http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip

43. The ban on new arrangements will have a **minimal cost loss of revenue** for financial advisers. Advisers will still be able to offer and provide the same services, but will need to be remunerated on a fee-basis rather than through commission.
44. Advisers are well positioned to offer services based on alternative payment models, other than commission. Following the RDR, which came into effect on 31st December 2012, advisers had to set up new fee-based charging structures. We expect these to be the same advisers affected by the forthcoming commission ban, because financial advisers would advise on different types of pension schemes across the pensions market. Further, the evidence set out above suggests that this direction of travel to fee-based charging structures has continued.
45. Whilst financial advisers will largely be able to respond to the ban on new arrangements with alternative fee-based structures if they wish to, this part of the ban will have minimal cost impact because the evidence suggests that new commission arrangements are rarely used in the specific part of the market affected by this ban, e.g. trust-based schemes used for AE. Providers in the 2015 charges survey did not report any initial/deferred commission arrangements (i.e. those more recently set up) for their trust-based AE schemes. There is a possibility that employers or members may be less likely to take advice if they face upfront costs as opposed to commission arrangements, but no evidence available to quantify this risk. In the broader context, the introduction of automatic enrolment is likely to increase demand for advice.
46. We understand through engagement with financial advisers that commission related revenue is a small and declining stream of revenue. During the consultation, one adviser body suggested that advisers have been moving away from this type of commission business, in favour of the greater and more profitable business available to them generated by the pension flexibilities introduced in April 2015. The potentially more costly impact for advisers would be due to the October 2016 part of the ban on existing commission arrangements.
47. Given that we believe so few advisers may incur a cost from the ban on setting up new commission arrangements, we do not attempt to estimate this cost here.

Employers

48. Employers who wish to seek advice from 6 April 2016 onwards will need to cover the cost. This may affect small and micro employers who have not yet automatically enrolled their employees at the commencement date. Where employers already have a scheme they can use, they will not need to seek advice. For employers who do not have a scheme, NEST offers a low-charge option into which they can enroll their employees without seeking advice. Other low charge schemes that do not involve any employer costs are also available and widely promoted within the market. Therefore, we expect employers to only seek advice where they feel the benefits outweigh the costs and it is in their interest to do so. Since it is optional whether employers seek advice, we estimate this as a **zero cost** impact. It is not necessary for employers to pay for advice to implement AE.

Members

49. Members will gain from the April 2016 ban by not having to pay for services they may not be in receipt of, and only paying for such services where they explicitly seek to do so.

<u>Costs and benefits of the October 2016 ban on existing arrangements</u>

Service providers

50. We estimate there will be a one-off administrative cost to service providers of stopping any existing deferred or trail commission arrangements. This cost will vary between different firms depending on factors such as the complexity of the systems that need updating.
    This one-off administrative cost will entail:

- step 1: the service providers identifying which of their schemes currently contain commission arrangements;
- step 2: communicating with advisers to inform them of the relevant arrangements affected by the ban and either a) setting up a new non-commission payment arrangement where members can opt-in to advice or services; or b) stopping the payments altogether
- step 3: updating systems to implement the ban
- step 4: confirming to the trustee that the commission arrangement has been removed

51. Providers should already be aware of whether they are or are not paying commission in respect of the schemes they run, so we do not calculate the ban introducing an additional cost in regard to step 1. Providers confirmed in the DWP Pension Charges Survey 2015 and during consultation that they are aware of whether or not they have commission arrangements.
52. The costs of steps 2 to 4 will vary depending on factors such as the number of schemes run by that provider which commission is being removed from and the age of the schemes. At the lowest end, we estimate this to take one week (approximately 40 person hours), for an associate professional at a rate of £19.10 per hour (including any non-wage costs)[24]. This totals a cost of £764.00 per service provider affected by the commission ban. Where there are a larger number of schemes to discuss, a variety of advisers in receipt of commission, or a greater complexity of commission to unpick and more systems to update, these costs will be higher. For example, if we assume that a professional would be doing this work rather than a pensions administrator at a median hourly rate of £24.77 (including any non-wage costs)[25] and that this work may take up to 4 weeks (160 hours) we obtain a maximum estimate of £3,962.40 per service provider.
53. The estimated total number of affected service providers is as follows: 50 administrators for trust-based schemes used for AE and 30 insurers for trust-based schemes used for AE[26]. The Pension Charges Survey 2015 found that 2 of 8 providers of qualifying trust-based schemes had any commission arrangements. This gives us an estimate of 25% of service providers who may need to incur this one-off administrative cost[27]. This means of our total of 80 service providers, we expect 20 to incur this one-off administrative cost of stopping existing commission arrangements.
54. We can multiply the estimated number of affected service providers by the minimum estimated cost for each service provider of £764.00, to give a lower estimate of a one-off administrative cost of £15,281. When multiplying the number of service providers by the maximum estimated cost for each service provider of £3,962.40, we estimate a higher one-off administrative cost of £79,248. Since, we expect the commission ban to be more onerous for some of the affected providers than for others, depending on the number of schemes and number of commission arrangements they have, we take an average between these two costs to give our best estimate of the total one-off administrative cost to service providers of £45,000.

[24] This estimate is based on the assumption that pension's administration is likely to be a higher wage paying profession than general administration. The hourly rate data are taken from ASHE, 2015 http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip. The estimated time taken to implement the changes is based on discussions with a range of providers during the consultation.

[25] ASHE, 2015: http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip.

[26] Estimates of insurers and administrators for trust-based AE schemes provided by The Pensions Regulator.

[27] The Pension Charges Survey 2015 related only to insurers but since we do not have further information available, we make the assumption that this estimate also applies to other service providers affected by the ban. We know from the 2015 survey that the prevalence of commission for trust-based schemes used for AE is low, so 25% affected is likely to be a reasonable assumption.

55. We do not expect any additional impacts on service providers above this one-off administrative cost as they are simply facilitators of member-borne payments to advisers in the case of deferred and trail commission. Service providers will also be allowed to recoup any money from members' funds that they have already paid up-front to advisers for initial commission, so will not lose any monies outlaid.
56. Some service providers indicated at the Government's consultation in October 2013 and during the recent consultation that the ban on commission arrangements will help them to meet the 0.75% charge cap on member charges introduced in April 2015.

Trustees

57. In the case of trustees, we believe the impacts of the October 2016 ban on existing arrangements will be part of the same process as for the April 2016 ban on new arrangements set out above as a **zero cost** impact.
58. Trustees will continue to be able to access advice and services. Any costs and charges will continue to be borne by the trust.

Financial advisers

59. Financial advisers may be impacted by the future loss or reduction in recurring income streams they receive from existing commission arrangements, although advisers will not be required to re-pay any commission they have received prior to the commencement of the ban.
60. To estimate the potential impact of the ban on existing arrangements to financial advisers, we follow the same modelling approach adopted in the Charges in Qualifying Pension Schemes IA[28]. Here we model the difference in pot sizes over ten years from the commencement of the ban in 2016 for a member with and without commission in their annual charge.
61. The modelling is based on a median earner in the automatically enrolled population who did not previously have a workplace pension until 2013, and who is estimated to earn around £20,000 in 2013[29,30]. The average annual charge for the individual without commission is set at 0.46% (based on the qualifying, trust-based average annual charge from the Pension Charges Survey 2015) and for the individual with commission this is set at 0.64% (based on the 0.18% weighted average charge of commission members in trust-based schemes used for AE are subject to – as described in paragraph 24). The average difference in pot size over the ten year period is estimated at £58 per member, per year. This can be viewed as the average loss to the adviser industry per year, for each member who is subject to commission arrangements.
62. Our best estimate of the number of members subject to commission arrangements in qualifying, trust-based schemes is approximately 20,000 members. If we multiply this number by the £58 per member, this gives an estimate of approximately £1.16m per year potential aggregate loss to the adviser industry.
63. This is our maximum estimate of the actual loss to the industry because this estimate assumes no advisers will re-negotiate their existing contracts to switch to fee-based payment models,

[28] Charges in qualifying pension schemes. February 2014. DWP IA No: DWP0042.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298302/ia-charges-qualifying-pension-schemes-feb-2014.pdf

[29] Department for Work and Pensions (DWP), July 2013, *Supporting automatic enrolment: further analysis of earnings, participation and provision,* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209864/ad-hoc-supporting-ae-further-analysis.pdf

[30] Our modelling is based on a median earner, earning £20,000 a year, with contributions at 2% for the first five years, 4% for the sixth year, 7% for the seventh year and 8% thereafter - in line with automatic enrolment requirements. Inflation is set at 2%, earnings growth is 4.5% and investment growth is 7%.

whereas industry evidence suggests that some advisers will make this switch. Further, adviser bodies advised us during the consultation that some adviser firms are being set up to take on this business where other advisers choose not to re-negotiate their existing contracts. This would result in a transfer between adviser businesses, rather than a net loss. However, since we do not have information to indicate how much business will be re-negotiated or transferred, we do not estimate any mitigated losses here.

Employers

64. Employers who have previously sought advice paid for via commission arrangements will not be affected by the October 2016 ban as this arrangement now exists between providers and advisers for whom the costs and benefits are discussed in the relevant sections.

Members

65. As with the ban on new arrangements, members will benefit from the ban on existing commission arrangements by no longer having to pay for services they may not have been in receipt of, and only paying for such services when they elect to do so.
66. All else being equal, members will see an increase in the value of their pension pot at retirement if providers reduce their charges after removing any commission payments. Since we do not know to what extent providers will reduce charges and to what extent advisers may re-negotiate their existing contracts, we can only make a simplifying assumption and produce a maximum estimate here – on the basis that providers would reduce members charges by the total amount they were paying due to commission, meaning that the benefit to members would be equal to the loss of income to providers, at approximately £1.16m per year across all members.

<u>Summary of costs and benefits</u>

67. Table 1 summarises the estimated costs and benefits set out above.

Table 1: summary of estimated costs and benefits of the commission ban

Parties affected by the ban	Familiarisation	April 2016 ban on new arrangements	October 2016 ban on existing arrangements
Service providers	**£4,000** (one-off *costs*)	**Zero**	**£0.05m** (one-off *costs*)
Trustees	**£0.03m** (one-off *costs*)	**Zero**	**Zero**
Financial advisers	**£0.05m** (one-off *costs*)	**Minimal** (*costs* not quantified)	**£1.16m** (ongoing, annual *costs*)
Employers	**n/a**	**Zero**	**Zero**
Members	**n/a**	**Zero**	**£1.16m** (ongoing, annual *benefits*)

<u>OI3O status</u>

68. Under the preferred option there is a direct impact on service providers, trustees and financial advisers, which is in scope of One-In Three-Out. We calculate all costs in 2015/16 prices. We estimate total costs to business as: 1) a one-off combined familiarisation cost for service providers, trustees and financial advisers of £0.08m; 2) a one-off administrative cost to service providers for removing existing commission of £0.05m; and, a maximum ongoing annual cost to financial advisers for lost income of £1.16m. Our EANCB assessment, calculated over a ten year period is £1.12m, representing a low cost regulatory IN.