Department for Work & Pensions

Government response to the consultation on

# Better workplace pensions: Putting savers' interests first

Presented to Parliament
by the Secretary of State for Work and Pensions
by Command of Her Majesty
February 2015

Cm 9000

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# Contents

# Introduction

1. This Command Paper forms the Government's response to the Better Workplace Pensions consultation conducted between 17 October and 14 November 2014. That exercise sought views on draft regulations to improve the governance of workplace occupational pension schemes providing money purchase benefits, and views on our proposals in relation to charges in occupational pension schemes that provide money purchase benefits used for automatic enrolment, as well as whether the drafting of the draft charges regulations achieve the policy intention. We are committed to creating the right protections for savers, particularly important now that over five million people have been automatically enrolled into a workplace scheme, and several million more will start saving or be saving more by 2018.

2. As we developed the proposals in the Better Workplace Pensions programme – covering governance, charges and transparency in workplace pension schemes – we undertook an extensive and rigorous process of analysis and consultation:

   - In July 2013, the DWP issued a Call for Evidence on governance standards in DC workplace pension schemes.[1]
   - Separately, in September 2013 the Office of Fair Trading published a market study of workplace defined contribution pensions, which contributed to DWP analysis of the workplace pensions market.
   - In October 2013, the DWP launched a consultation on charges in workplace pension schemes used for automatic enrolment[2].
   - In March 2014, the DWP published a Command Paper, *Better workplace pensions: Further measures for savers*[3] that confirmed its intention to control charges in certain workplace pension schemes used for automatic enrolment, and launched a consultation on governance in workplace schemes.

1 https://www.gov.uk/government/consultations/quality-standards-in-workplace-defined-contribution-pension-schemes
2 Cm 8737 – https://www.gov.uk/government/consultations/better-workplace-pensions-a-consultation-on-charging
3 Cm 8840 – https://www.gov.uk/government/consultations/better-workplace-pensions-a-consultation-on-charging

- In October 2014, the DWP published a second Command Paper, *Better workplace pensions: Putting savers' interests first*[4] confirming its intentions to improve occupational scheme governance, making further proposals on how the charges measures should be implemented, providing a high-level plan to introduce greater transparency around costs and charges in due course, and launching a consultation on draft regulations relating to both governance and charges in certain occupational pension schemes.

3. The updated draft regulations, to be laid before Parliament today, derive mainly from primary powers taken in the Pensions Act 2014, and, subject to Parliamentary approval, will mainly come into force on 6 April 2015[5].

4. This Command Paper is structured as follows:

   - The Government's response to its consultation on the draft regulations relating to the governance of certain workplace occupational pension schemes.
   - The Government's response to its consultation on the development of the policy towards charges in relevant workplace occupational pension schemes used for automatic enrolment and the supporting draft regulations.

5. The draft regulations relate to the money purchase benefits provided by occupational schemes only (subject to certain exceptions as set out in the regulations). The firms that provide workplace personal pensions are regulated by the Financial Conduct Authority (FCA). The FCA have now completed their consultations on making equivalent rules relating to governance and charges for those schemes, including the introduction of Independent Governance Committees (IGCs), and will publish their final rules soon. These rules will also come into force on 6 April 2015, apart from the ban on Active Member Discounts, which will come into force on 6 April 2016.

6. We are grateful to the many individuals and organisations that have responded to all the DWP consultations, including the most recent one. We have had a wide variety of views from a broad range of sources, and that input has enhanced the policy and regulation making process. We believe the final draft regulations laid before Parliament strike the right balance between protecting savers and supporting the roll-out of automatic enrolment by existing schemes and pension providers.

## Next steps for improving pensions

7. The first phase of the Better Workplace Pensions agenda comes into effect from April 2015, subject to Parliamentary approval. There are a number of areas where the Government proposes to bring forward further measures or legislation. These are as follows:

8. **Enhanced transparency of costs and charges:** Since the publication of "Better workplace pensions: Putting savers' interests first", the DWP has been working closely with the FCA in relation to the next phase of the work to introduce greater transparency of costs and charges. This will build on the new governance requirements for reporting costs and charges in the Chair's annual statement and IGC's annual report. A joint DWP/FCA call for evidence is planned for publication in Spring 2015. This will describe the research conducted to date in relation to the reporting of costs and charges, with particular reference to transaction costs, and will

[4] Cm 8929 – https://www.gov.uk/government/consultations/better-workplace-pensions-putting-savers-interests-first
[5] Subject to Parliamentary approval, the draft regulation banning Active Member Discounts will come in to force on 6 April 2016.

seek the views of stakeholders in relation to how costs and charges may be reported in a standardised, consistent and comparable format and what mechanisms may be suitable to enable this reporting to take place. The DWP and FCA will use the information gathered as part of this exercise to inform the development of the policy and legislation during 2015, with a view to a consultation on how we propose to introduce additional charges and costs transparency. The FCA will also be consulting on similar new costs and charges transparency requirements in relation to workplace personal pensions.

9. **Commission regulations:** The Government announced in its March 2014 Command Paper that all member-borne advisor commission payments will be banned in qualifying schemes used for automatic enrolment from April 2016. The recent FCA consultation included draft rules to ban these payments in workplace personal pension schemes, as well as consultancy charges (to be banned from April 2015). Consultancy charges were established in FCA rules as an alternative to commission for Group Personal and Group Stakeholder Pensions, following the Retail Distribution Review. During 2015, the DWP will consult on corresponding regulations for occupational schemes used as qualifying schemes for automatic enrolment. We will also consider whether these regulations should be designed in such a way as to prevent the development of consultancy-style charges in occupational schemes in future.

10. **Post-implementation review:** In 2017, the Government and regulators will conduct a post-implementation review of all the Better Workplace Pensions measures to assess their effectiveness in protecting savers from high and unfair charges, improving governance in members' interests and increasing transparency of costs and charges throughout the value chain. In particular, the review will consider the level of the charge cap and whether this remains appropriate, or should be changed, and whether to include some or all transaction costs within the cap.

# Scope 1

## Chapter 1 – Scope

1. Our October 2014 Command Paper, *Better workplace pensions: Putting savers' interests first* (the October Command Paper) aimed to help trustees, providers, managers and administrators of workplace pension schemes understand how the Government intended to legislate for the charges and governance measures. The Command Paper also sought comments on the policy in relation to charges, as well as on the draft charges and governance regulations. We also clarified how terms and definitions commonly used in the workplace pensions market would be defined in respect of these measures. We explained that our draft regulations would apply to occupational pension schemes that are money purchase schemes and to the money purchase benefits provided by other schemes (subject to certain exceptions). We also announced that the Financial Conduct Authority (FCA) would make corresponding rules for workplace personal pension schemes.

## The scope of the governance measures

**Consultation question:** Does the definition of "relevant scheme" (at regulation 14) meet the policy intention of ensuring that workplace schemes are well governed in members' interests?

2. We proposed in the October Command Paper that the following scheme types should be excluded from the governance measures:

   - relevant small schemes, which have fewer than 12 members and where all of these members are trustees, and either the rules of the scheme provide that all decisions are made only by the trustees who are members of the scheme and by unanimous agreement; or the scheme has an independent trustee and that trustee is registered on The Pensions Regulator's ('TPR') register of trustees. These schemes are commonly termed 'small self-administered schemes' and we therefore use this terminology from this point onwards;

- executive pension schemes, where a company is both the only employer in relation to the scheme and the sole trustee, and the members of the scheme are either current or former directors of that company and include at least one-third of the current directors;
- public service pension schemes which are covered by the Public Service Pensions Act 2013 (which amends the Pensions Act 2004);
- schemes which are not covered by the requirement for an annual report and other information, as set out in the Disclosure Regulations[6];
- schemes which provide no money purchase benefits other than benefits which are attributable to the payment of Additional Voluntary Contributions ('AVCs').

3. Most respondents supported the scope of the governance arrangements or did not express a view.

"We support the proposal for the schemes that are to be covered by the governance measures, in particular the exclusion of AVC-only schemes. We agree that these should not be subject to an additional layer of governance."

**EEF**

4. However one respondent thought that, as TPR's code of practice on Governance and Administration of Occupational Defined Contribution Trust-based Pension Schemes currently includes AVCs within their scope, we should also include them within our governance provisions. Another respondent was concerned about how the reporting on costs and charges would work for those schemes where the only money purchase benefits were AVCs, (and so these schemes would not be covered by the governance arrangements).

5. Not all AVCs will be excluded from the proposed governance regulations. They will only be excluded where they are the only money purchase benefits in the scheme, either because they are the only benefits, or because the only other benefits are non-money purchase. Here we have concluded that to require an additional layer of governance would be disproportionate, given that members paying AVCs will generally have made an active choice, and so we would expect them to be more fully engaged. Where a scheme provides money purchase benefits apart from AVCs, our view is that it is proportionate to require that the AVCs, along with the other money purchase benefits, will be subject to the new governance requirements.

6. We do not propose to make any changes to the draft regulations which define the scope of the governance measures.

## The scope of the charges measures

**Consultation question:** Does the definition of "relevant scheme" (regulation 2) meet the policy intention of protecting members of schemes used for automatic enrolment from high and unfair charges?

7. The October Command Paper proposed that small self-administered pension schemes and executive pension schemes would be excluded from the charges measures, in common with the scope of the governance regulations. We also proposed that the charge cap should not apply to schemes that contain a third party promise, as the charge cap was not designed with the costs of providing a promise in mind.

[6] The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (SI 2013/2734).

8. We received a range of comments about the proposed scope of our measures. Many respondents agreed with this scope.

"Zurich supports the application of the charging provisions to money purchase schemes which are used as qualifying schemes, the members of which may not have made an active choice. We further support the exclusion from the charging provisions of relevant small schemes and executive pension schemes, the members of which might reasonably be expected to be more engaged and better able to influence their own outcomes."
**Zurich**

9. Several respondents provided helpful technical drafting comments. As a result, we have made a number of minor modifications that will assist in making the regulations clearer. Other respondents provided more detailed comments concerning several aspects of the proposed scope, including: the treatment of AVCs; the exclusion of small self administered schemes and executive pension schemes; and how the cap would apply to schemes with third party promises. These areas are covered in turn in the following paragraphs.

10. In our October Command Paper, we proposed that the charges measures would apply to AVCs where these formed part of a scheme which was being used as a qualifying scheme. This is because members of these schemes should be protected from unfair charges regardless of the type of contribution. Moreover, the Government wishes to encourage members to increase their pension savings through AVCs. Therefore, the ban on Active Member Discounts will apply to AVCs where these are used in qualifying occupational schemes from April 2016. It is the Government's intention that commission will also be banned from AVCs in qualifying occupational schemes from April 2016 and we intend to consult on draft regulations to achieve this in 2015.

11. We also proposed that AVCs in qualifying schemes should similarly be protected by the default fund charge cap, where the AVCs were made to a default arrangement. An arrangement established solely for the purpose of receiving AVCs will not meet the criteria to be defined as a default arrangement subject to the charge cap, unless it is designated as the default arrangement for other workers of that employer. This is explained further in paragraphs 40 to 50 of chapter 3.

12. The difference in approach to AVCs between the charges and governance measures drew some queries about reporting from some stakeholders.

"The governance requirements will not apply to specified schemes, including those used to provide defined contribution AVCs. However, the charge cap will apply to these arrangements, so it is unclear who in the governance framework is responsible for monitoring the charge cap and publishing the required information."
**Aquila Heywood**

13. We recognise that trustees and managers of relevant qualifying schemes providing no money purchase benefits other than AVCs will need to comply with the ban on AMDs despite not being required to complete a Chair's Statement (see Chapter 2) and are content that this approach is appropriate. Schemes, which are not covered by the requirement for an annual report, as well as public service pension schemes are in a similar position. These schemes would still be expected to confirm compliance to TPR via their scheme return, as set out in regulation 24 of the proposed draft regulations (which amend the Register of Occupational and Personal Pension Schemes Regulations 2005 (SI 2005/597)). We consider that this will ensure an adequate level of reporting.

14. Most respondents agreed with the exclusion of small self-administered schemes and executive pension schemes. Some also suggested that single-member schemes should be excluded from the charges measures in the same way that they are exempt from the governance measures.

"The stipulation that one third of the members of the scheme must be current directors does not fit with the historic way that these schemes were set up. It was common for each individual with such a benefit to have a scheme or arrangement in isolation of other employees/directors."
**Aviva**

15. We believe that the majority of single member schemes are likely to fall within the existing exemptions for small self-administered schemes or executive pension schemes, which means that the members are effectively running the scheme, so there is very limited risk of specific member detriment from not applying the charges and governance requirements. However, having considered the responses, we agree with respondents that executive pension schemes where each director is in a separate single-member scheme may not be excluded by the existing provisions, but ought to be. We have therefore amended the definition of relevant scheme in regulation 2(2) to exclude schemes with only one member.

## Third party promises

**Consultation question:** Do the draft regulations meet the policy intention of excluding from the charge cap members of qualifying schemes who have the advantage of a third party promise?

16. The October Command Paper explained that the charge cap would apply to money purchase benefits in the default arrangements of schemes which are used as qualifying schemes for at least one jobholder. We also proposed that the default arrangement charge cap should not apply to schemes that contain a third party promise, because the charge cap was not designed with the costs of providing a promise in mind. A number of respondents raised queries about the application of the charge cap to schemes with promises.

17. Respondents' comments regarding promises broadly fell into two main categories. The first related to a wish for greater clarity on what constitutes a promise.

18. The term 'promise' itself is intended to have its everyday meaning. The Pension Schemes Bill[7] before Parliament uses this terminology which will mean it will become more familiar to the broader industry over time. The current clause 5 of the Bill provides more information about what will constitute a pensions promise. However, many of the comments and questions about promises related to arrangements which were not money purchase benefits – the charges measures do not apply to these (see regulation 2(2)).

19. Money purchase benefits are defined in sections 181 and 181B of the Pension Schemes Act 1993, as amended by section 29 of the Pensions Act 2011[8]. Section 181B(2) states that for a benefit to be a money purchase benefit, its rate or amount must be "calculated solely by reference to assets which (because of the nature of the calculation) must necessarily suffice for the purposes of its provision to or in respect of the member." In other words, a funding deficit cannot arise in relation to a money purchase benefit.

[7] Currently clause 5 of the Bill – see: http://services.parliament.uk/bills/2014-15/pensionschemes.html
[8] http://lawvolumes.dwp.gov.uk/docs/a5-1251.pdf

20. This definition has the effect that, generally, money purchase benefits do not provide promises to members (other than where it is provided by a third party – this is explained further below). Those running schemes will need to consider first whether the benefits offered by the scheme are money purchase benefits under the legal definition. However, by way of an example, where a scheme offers a guaranteed increase in the value of units by 4% per annum, or a guarantee that the value of units will not fall, it would generally be possible for the scheme to run a deficit and funding and solvency requirements may be triggered. If this is the case, then the arrangement would not be a money purchase benefit and therefore not be subject to the charges measures.

21. Such an arrangement would also generally meet the definition of a promise in the current Pension Schemes Bill. Even if the provider retained the option of imposing a Market Value Reduction on members who withdrew the funds ahead of a specified age or date, there would still be a promise, at a time before the benefit comes into payment, about the level of the benefit.

22. On the other hand, some with profits arrangements are money purchase arrangements. For example, money purchase arrangements that offer smoothed returns with no underlying guarantee or reversionary bonuses. They may do this by withholding returns on years when the underlying assets performed well and releasing them on poorer years, but retain the option to reduce the value of members' benefits in some circumstances, for example after a succession of poor years. If such a with profits arrangement was established in such a way that it could not run a deficit and did not trigger funding or solvency requirements, the benefits would be money purchase benefits and the charges measures would apply if this arrangement were used as a default to meet an employer's automatic enrolment obligations. Likewise such an arrangement would not offer a promise.

23. There is one instance where a promise is provided whilst the benefits are money purchase. This occurs when the scheme, or the provider who holds the contract with the individual does not bear the funding liability itself, but has a contractual agreement with a third party that they will hold this liability instead. In this case, the benefits would be money purchase – because even, say, in a run of exceptionally poor years, the scheme itself would not run a deficit. However, there would still be a promise, provided by the third party.

24. We have therefore specifically excluded money purchase schemes with a third party promise from the cap in the draft regulations (see regulations 3(6), (7) and (8)).This is because the funding liability is borne by the third party and not the scheme. As we do not want the charge cap to apply to schemes with promises, we have applied the cap to money purchase benefits only, and then also specifically excluded money purchase schemes with a third party promise from the cap in the draft regulations. These queries have identified that some of those running pension schemes need to consider the definition of money purchase benefits in more detail.

25. The second category of comments related to the scope of the exemption and whether it should be restricted to ensure members are protected. Some respondents suggested that the value of the promise should be a factor in determining whether the exemption should apply. We expect that trustees' fiduciary duties in trust-based schemes, with regulatory principles operating in a similar way in workplace personal pension schemes, should mitigate the risk of schemes using low value promises to evade the cap.

"We appreciate that it is difficult to word legislation such that it provides for a qualitative analysis of the value of any guarantee and while it does allow gaming we would hope that avenue would be closed by the trustee requirement to ensure value for money."

**Friends Life**

26. Other respondents queried whether the exemption of **schemes** that provide a third party promise was too wide. The Government's original intention was to ensure a balance between protecting members and supporting the rollout of automatic enrolment by limiting the burdens on trustees and providers. After considering all of the responses we agree that the exemption should be tightened because, as drafted, the default arrangement would not be subject to the cap even if the third party promise related to a different fund within the same scheme, which did not form part of the default arrangement.

27. Respondents suggested three options to address this. The first was to limit the exemption to the benefit offering the third party promise, the second to limit it to the cost or charges relating to the promise itself and the final option to limit it to the default arrangement containing the third party promise. We have considered the advantages and disadvantages of these options and concluded that the third option strikes the right balance in ensuring members are protected without being unduly burdensome on trustees and providers. We have amended the regulations to be laid before Parliament accordingly (regulations 3(6), (7) and (8)) but will keep this under review in case a further change is needed to protect members in future.

## Summary of changes

**We have not made any changes to the scope of the governance measures.**

**We have excluded single member schemes from the charges measures – these schemes are already excluded from the governance measures.**

**We have narrowed the exclusion from the charge cap in respect of third party promises. Now a default arrangement will only be excluded from the cap where it offers a third party promise. A third party promise in relation to a separate fund within the scheme will not exclude the default from the cap.**

# Minimum governance standards in workplace pension schemes 2

## Introduction

1. Good governance of workplace pension schemes is fundamental to securing good outcomes for members. 'Better workplace pensions: Putting savers interests first' confirmed that Government and regulators are putting in place a series of measures to improve how both occupational and personal workplace pension schemes, that provide money purchase benefits, are governed.

2. We want to ensure that people running pension schemes are informed, focussed on key areas and have members' interests as their priority.

3. In the October Command Paper we asked four questions (questions 3 to 6) about whether the draft regulations met the policy objectives in relation to governance. Respondents generally felt that the regulations achieved these objectives. This chapter summarises the responses received to each question and the Government's response.

## Appointment of service providers

4. We want to ensure that trustees have the freedom to change service providers where they deem this to be in members' interests. It is key to good governance that trustees should not be constrained in fulfilling their duties to members by being restricted in their choice of service provider.

**Consultation question:** Do the regulations achieve the policy intention of protecting against trustees being restricted to particular service providers, while allowing employers to set appropriate parameters around investments?

5. Most respondents either agreed that the regulations achieved the policy intent or did not express a view.

"Yes, ShareAction fully supports this regulation. A governance structure can only be considered fit for purpose if the trustees have the ability to move funds out of underperforming vehicles and terminate relationships with underperforming suppliers. We do not envisage any unwanted consequences arising from this regulation"

**ShareAction**

6. Some respondents thought that the potentially wide scope of draft regulation 6A could be interpreted as limiting trustees' abilities to enter into certain types of contract. For example, some thought a consequence of this regulation could be that trustees may be reluctant to enter into contracts with lock-in periods which can be at lower cost and offer better value for the members. Similarly, some though that trustees could be restricted in their ability to enter into good value contracts which contain express or implied restrictions on other providers that can be used.

" ... An administration contract can have high initial take-on costs. As such the contractor will look to recover these costs by spreading the charge over a lock in period of between three and ten years (depending on the nature of the scheme, its systems and records). The advantage of such a commitment from the trustees point of view is that

- it allows a greater investment in effective scheme administration infrastructure
- costs are lower; and
- budgeting for future years is much more predictable

We would not wish to see the legislation interpreted to prevent reasonable contract terms"

**Capita**

7. Some respondents pointed out that setting up a scheme such as a master trust can require an upfront investment and that it can take many years before fees charged to members supported the expenses of running a scheme. These respondents thought that regulation 6A as drafted could restrict the ability of providers or their backers to protect their investment in these schemes, which could then reduce competition as it might result in fewer providers in the market.

8. A smaller number of respondents offered solutions to this problem. The most radical was to exempt master trusts completely from this requirement. Another suggestion was that our regulations should allow master trusts to make provision which was reasonable to both protect members' interests and the investment of the service provider in the operation of the scheme. One provider suggested that we should limit the trustees' ability to change the service provider within a period of, for example, three years from the commencement of the trust only where otherwise members' interests could be prejudiced.

9. A small number of respondents mentioned bundled arrangements; one in particular commented that schemes that are part of a bundled arrangement may find that the range of investments available are restricted, and that the costs could be non-negotiable. However, as long as the trustees have the ability to move both the administration and the investment to another provider or providers they thought that this should be acceptable.

10. We agree that trustees should be able to enter into contracts with service providers, and it has not been our intention to prevent trustees from doing so. Our intention is for Regulation 6A, as inserted by regulation 15, to cover trust deeds and scheme rules – so that these provisions cannot be used to constrain trustees in their choice of provider – rather than other types of arrangements such as contracts. We do, of course, expect trustees to satisfy themselves that these contracts represent good value for members and that any long term arrangement is written on competitive terms.

11. We have amended the drafting of regulation 6A, as inserted by Regulation 15, to make it explicit that only restrictions in trust deeds and scheme rules will be captured by these provisions.

12. We recognise that there are significant upfront costs in setting up a scheme and that these can take time to be recovered. However, we do not think that it is necessary to make special provision for these cases.

**We have amended the drafting of regulation 6A, as inserted by Regulation 15, to make it explicit that only restrictions in trust deeds and rules will be captured by these provisions.**

## Definition of professional trustees

13. We want to treat companies that provide professional trustee services as if they were a single trustee for the purposes of our legislative requirements on the independence requirements for multi-employer schemes, and appointing a chair of trustees.

**Consultation question:** Do the regulations adequately describe professional trustees?

14. The majority of respondents were happy with our definition or did not express a view. However, some stakeholders thought there were ways we could give the definition greater clarity and we are grateful for these suggestions.

15. Some respondents thought that a differentiator of a genuine professional trustee body was that it was carrying out its trustee functions in the ordinary course of business and that this should be reflected in the regulations. We have therefore added new sub-paragraph (d) to the definition of "professional trustee body" in regulation 16, which requires that a professional trustee body must be carrying out trustee functions in the ordinary course of their business.

16. Another respondent thought that, as master trusts may be established by third parties such as insurers or service providers who may or may not then participate in the trust for their own staff, the definition of professional trustee body should specify that the body was not established by a "sponsor" in relation to a scheme rather than just an "employer". They also suggested including a reference in the second limb of the definition to the trustee as being remunerated for its services as a trustee of "this and other schemes", on the basis that genuine professional trustee firms have multiple appointments.

17. We recognise that there are parties other than employers who establish master trusts and have therefore considered extending the definition in regulations to refer to these parties. Given the variety of different master trust arrangements, we are however concerned that it may not be possible to come up with a definition that usefully captures all these circumstances, and have not therefore amended limb (a) of the definition. As mentioned earlier, we have added a new sub-paragraph, (d), which requires that a professional trustee body must be carrying out trustee functions in the ordinary course of their business, and think this adequately describes the arrangements the regulations are intended to cover.

18. We have considered the risks and benefits of including a reference in the definition to the professional trustee body being a "trustee for this and other schemes". We are concerned that this definition could prevent new entries into the professional trustee market, an outcome which might not be desirable, particularly given the existing dominance of a few firms in the market. We think it preferable that professional trustee bodies that provide services to only one scheme (for example because they are new, or have lost business) should be treated in the same way as bodies with multiple appointments and therefore have not made changes to sub-paragraph (b) of this definition in regulations, other than to clarify that the trustee may be remunerated for its services as a trustee by one or more schemes.

19. A couple of respondents also thought that where regulations refer to 'insurance' as part of the definition of a professional trustee, that this should refer specifically to indemnity insurance. On the other hand, one respondent thought that as most trustees had this type of insurance whether they were professional trustees or not, it is not a useful indicator of a professional trustee and should not therefore be included in regulations.

"The purpose of 15(1)(a)(c) of part 3 chapter 2 of the draft regulations is unclear. Does the DWP mean an insurance policy for the delivery of the benefits of the trust (for example, is this only to apply to "insured" master trusts) or an insurance policy in relation to professional indemnity?"
**PTL**

20. We agree that on its own, whether or not a professional trustee has indemnity insurance would not define its status. However, as part of the overall definition of professional trustee, we continue to think this is a useful indicator. We have therefore retained the reference to insurance in the definition in regulations, but amended this so that it refers specifically to indemnity insurance.

21. A small number of respondents also suggested that the definition should refer to the quality of these trustees and that there should be a test to ensure that a professional trustee is suitably qualified for the exercise of their duties.

"As the number of trustees is to increase three-fold we think there should be some quality parameter to ensure that the professional trustee is suitably qualified for the proper exercise of their duties".
**Elston Consulting**

22. We agree on the importance of professional trustees having the skills and experience to properly govern a scheme. However, we do not propose making any changes to the regulations to reflect the skills and competencies of professional trustee bodies, as existing requirements in the Pensions Act 2004 (sections 247 and 248) and TPR Code of Practice no 7 on Trustee Knowledge and Understanding already set requirements for professional trustees as well as individual trustees

23. Some respondents also pointed out that for the purposes of appointing a chair, and the master trust independence requirements, our regulations provide that if an incorporated trustee is not a professional trustee then only individual directors can be included in our provisions. Sometimes, professional trustees sit on these boards, as corporate entities rather than individual directors. Respondents suggested that the regulations should be amended to reflect this.

"We believe that it is reasonable for a professional trustee to be appointed as a director of a new incorporated trustee, and this is clearly envisaged as an option by paragraph 104 of Chapter 2 of the Command Paper. However, as currently drafted, it would not be possible to appoint a professional trustee to the new corporate trustee board other than in an individual capacity."
**TISA**

24. We recognise that sometimes professional trustee bodies can sit on corporate trustee boards and our regulations as drafted did not reflect this. It is our policy intent that professional trustee firms should also be able to be recognised as directors of incorporated trustees and we therefore are amending the regulations accordingly.

**We have amended the definition of "professional trustee body "to require that they must carry out trustee functions in the ordinary course of their business.**

**We have made some other minor amendments to this definition.**

**We have amended the regulation to ensure that professional trustee firms can be recognised as directors of incorporated trustees for the purposes of the governance requirements.**

## New requirements for multi-employer schemes

25. The term "master trust" does not have an agreed single definition and we have not sought to create one in these regulations. The regulations are instead concerned with those "multi-employer schemes" that should be subject to additional requirements for independent governance.

**Consultation question:** Does the definition at regulation 1(2) capture those schemes defined as master trusts in Chapter 2?

26. The term "relevant multi-employer scheme" is defined in regulation 1(2) of the Administration Regulations as follows:

- a relevant scheme where some or all of the participating employers are not connected employers; or
- which is promoted as a scheme where participating employers need not be connected.

27. In the consultation draft of the regulations, there were two exemptions from this definition; the first concerned schemes with distinct sections relating to employers which are not connected and where each of those sections is governed by a different trustee.

28. The second exemption is for the National Employment Savings Trust (NEST). There are already particular (usually higher) governance requirements for NEST set out under the Pensions Act 2008 and we do not want our new regulations to contradict these.

29. The definition in regulation 1(2) refers to "connected employers" to ensure that those schemes where the participating employers are part of the same corporate group are not subject to the independence requirements. A participating employer is defined in new regulation 1(2ZA) of the Administration Regulations as any employer currently or previously participating in the scheme in accordance with the scheme rules. The reference to previous participation is intended to ensure that schemes with deferred members are subject to the same requirements as those being actively used.

30. In defining "connected employers", our regulations refer to provisions in section 1159 of the Companies Act 2006 and to partnerships where each partnership has the same person as at least half of its partners.

31. Most respondents were either happy with our definition or did not express a view. Some respondents however thought the definition too wide and in particular that it should not capture industry-wide schemes. The industry-wide, former public sector scheme, was concerned there could be negative consequences if the independence requirements were to apply in their case. The scheme was set up under statute with requirements for a robust governance structure to be in place. That respondent informed us that an entirely new governance structure for this scheme would be burdensome and very costly and, due to the procedures involved, would not be possible by April 2015.

32. Some respondents also queried the wording of the draft used in regulations, which defines the first limb of “relevant multi employer scheme” as one where “some or all of the participating employers are not connected”. In this instance, we take the view that the ordinary meaning of “some” is more than one. Schemes where all but one of the participating employers are connected would therefore not be captured by this definition. This might include a situation where a joint venture includes one company which is connected and one which is not, or where the outcome of merger and acquisition activity produces an employer that is unconnected for a temporary period but remains within the scheme.

33. We have considered responses on the general issue of whether our definition of relevant multi-employer scheme is too wide. We are conscious that there are a variety of different types of multi-employer schemes in operation. We have therefore taken a broad approach to defining these schemes in the regulations rather than attempting to define in detail the various types of scheme to which these requirements should apply (for example by trying to define the difference between schemes which are only open to employers operating within the same industry and those that have a broader membership). We believe the new independence requirements are relevant to this broad group of multi-employer schemes. We therefore have not amended the definition in response to these general comments.

34. However, we recognise there may be good reasons to exclude schemes set up by statute (mainly ex-public sector schemes) from the multi-employer scheme independence requirements. We would not want to impose disproportionate burdens on schemes set up by statute by requiring a different and additional layer of governance if they already have robust arrangements in place. Even though all schemes will be given a three month period of grace to comply with the multi-employer scheme requirements, we understand that this is unlikely to be sufficient time for these schemes to comply, and to knowingly place them in breach when robust governance arrangements are already in place would be difficult to justify.

35. We have therefore amended the draft regulations to include a temporary exemption for those multi-employer schemes that are established by statute (in other words where there remains some degree of Government control or the governance arrangements are set out in statute). We propose that this exemption for schemes established by or under statute will cease to have effect from April 2016. We consider this to be the most suitable date as that is the intended start date for Phase 2 of the transparency requirements.

36. Later this year we will consult on what the governance arrangements for these multi-employer schemes set up by statute should be, with a view to making further provision where necessary through secondary legislation. This will allow us to establish how many and what kinds of schemes would fall into this category and whether their governance arrangements are sufficient to meet our policy objectives.

37. Other respondents raised a variety of technical queries on the definition of participating employer. For example, one stakeholder queried whether our definition of participating employer might inappropriately extend to mergers and acquisition situations where an employer might continue to participate in a previous arrangement for a limited period of time.

38. A small number of respondents also queried why previously participating employers are included in the definition. Some thought it inappropiate that this would convert a group-wide scheme into a multi-employer scheme where a previously participating connected employer is sold out of the group but remains within the scheme.

"We suggest that, provided all employers are connected while they are participating employers that should be sufficient for the purposes of establishing that a scheme is not a "relevant multi-employer scheme" for the purposes of regulation 1(2)."

**Eversheds LLP**

39. Another respondent suggested we should consider excluding schemes where the accrual of contributions has ceased before April 2015 on the basis that there was limited value in imposing additional requirements on such schemes.

40. We have carefully considered the points made by respondents about previously participating employers converting a group wide scheme into a relevant multi-employer scheme within our definition, and whether we should make specific provisions to exclude deferred members from scope. However, on balance we think that no change to the regulations is desirable. Nor do we consider it appropriate to exclude schemes where accrual of contributions has ceased. This is because we consider it important to ensure that all members, both deferred and active, are protected by good governance and do not want to weaken our governance measures by changing the definition at this stage.

**We have amended the draft regulations so that there is a temporary exemption for those multi-employer schemes that are established by statute, and this will cease to have effect from April 2016.**

**Later this year, we will consult on what the governance arrangements for these multi-employer schemes should be, with a view to making further provision if necessary through secondary legislation.**

## Overall requirements

41. Our final consultation question was included to seek views on whether the draft regulations met our policy intention of ensuring that occupational schemes are well-governed, with competent trustees and managers who put members' interests at the heart of everything they do.

**Consultation question:** Do the draft regulations meet the policy intention of ensuring that occupational schemes are well governed?

42. Overall, there was widespread agreement that generally these regulations support the policy intention of ensuring that occupational schemes are well governed. Some respondents expressed views on policy as well as the regulations. We are unable at this stage to make changes where respondents raised new policy questions as this was outside the scope of the October consultation, which was solely on whether the draft governance regulations met the original policy intention. We have summarised the specific points made below.

43. **Length of Chair's Statement:** A number of respondents thought the chair's statement was overly long and the requirements too prescriptive, and that this would be burdensome for schemes.

"The regulations on Chair's Statements should be kept high level so that trustees can focus on the issues that matter to their scheme. The DWP should amend the draft regulations on Chair's Statements to make the list of items to be covered shorter and less prescriptive."

**NAPF**

44. Our initial assessment is that in reducing any of our current regulatory requirements we risk undermining the effectiveness of the governance provisions and so we do not propose to take any action to alter the requirements in the Chair's Statement. While the regulations set out the particular areas that the statement must cover, there is flexibility about how trustees address these areas. We intend to set out more detail about the Chair's Statement in guidance.

45. **Assessing the value of costs and charges:** Some respondents thought it would be difficult for trustees to obtain information from providers on transaction costs. Others thought it would be difficult for trustees to assess whether charges and transaction costs offer good value for members and said they would welcome guidance on this issue.

"Neither good value nor VFM are defined in statute or legal precedent, practice nor academically. While the concept is widely accepted its definition is subjective and individual. PTL supports the principle of assessing and delivering good value. We also support the principle of transparency in governance. We are, however, very concerned about enshrining in law an obligation to assess a concept that is not defined."

**PTL**

46. We do not want to make the regulations more prescriptive in this area because we expect trustees, as part of their general role and fiduciary duty to members, to already have a good understanding on how they assess the value of charges and costs for their particular scheme and membership. The Pensions Regulator has published guidelines on value for money[9] on their website which we would expect trustees to use as a base line for consideration.

47. **Who is responsible for appointing the chair:** In the October Command Paper we confirmed our intention that there should be a chair of trustees with responsibility for signing off the annual Chair's Statement, and our draft regulations expressly said that "the trustees... must appoint a chair of the trustees".

48. Some respondents thought this could be too restrictive as sometimes scheme rules include specific provisions as to how a chair is appointed, including giving the employer, rather than the trustees the power to appoint the chair.

[9] http://www.thepensionsregulator.gov.uk/professionals/value-for-money-in-your-clients-dc-schemes.aspx

"Our concern is that the majority of trust schemes provide already (in scheme rules or in the Articles of Association of any trustee company) for the appointment of a chair. In many cases, this appointment is within the employer's gift and often the chairman will have a casting vote. Imposing a requirement for trustees to appoint a chair will fundamentally change the balance of power in many schemes.....We suggest that the legislation should provide for there to be a chair without specifying who is to make the appointment – except maybe in default"

**Association of Pension Lawyers**

49. This is also an area where schemes set up by statute may have legislative provisions about how the chair of trustees is appointed. For example, as regards NEST, there are specific primary provisions in the Pensions Act 2008 as to who appoints the chair.

50. We recognise there is a need to cater for situations where it is not the trustees that appoint the chair, or where there are already provisions within the scheme rules governing the appointment of a chair. We are therefore making a drafting change to the regulations, which is consistent with our original policy intention as expressed in the consultation document. This stipulates that trustees must appoint the chair *where the scheme does not already have a chair in place*. This covers situations where there already is a chair, and those schemes where, for example, the chair has already been appointed by the employer.

51. **Timing of the Chair's Statement:** Our original regulations set out that the Chair's Statement should be produced on an annual basis within 7 months of the end of the scheme year. They provided that where the first scheme year ending after 6th April 2015 is sooner than 5th April 2016, the Chair's Statement should relate to the period from 6th April 2015 to the end of the first scheme year. However some respondents queried the timing of this statement and asked whether a statement would still have to be produced where the scheme year ends, for example on 30th April, as that would result in a chair's statement that relates to a very short period of time.

"We do have some concern in respect of draft regulation 23 (2). Whilst we support the need for annual statements to be aligned to "scheme years", and further that the first statement will therefore cover the period from 6th April 2015 to the scheme year end prior to 5th April 2016, it does not appear meaningful to have to produce a statement which is in respect of anything less than a 3 month period. We would request that further consideration is given to this point."

**Prudential**

52. Given that this is a one-off situation that will only apply for the first year of the governance arrangements, we have amended the draft regulations to require that schemes should not have to produce a Chair's Statement from April 6th 2015, if the period covered is less than 3 months. In these cases, schemes would roll that statement up into the next year's version which would therefore cover a period of more than 12 months. So, for example, where the scheme year ends on 30th April, the first chair's statement would be due within 7 months of the scheme year ending 30th April 2016 and would cover the period 6th April 2015 to 30th April 2016.

53. **Duration requirements for multi-employer schemes:** Some respondents also queried how the provisions on the duration of appointment for independent trustees of multi-employer schemes would work, and thought that the wording of the regulations did not in themselves give sufficient clarity. We have not altered these requirements, but will provide further information in guidance as to how these requirements work.

54. **Use of the word "company":** Another respondent mentioned the use of the word "company" in the context of the multi-employer scheme independence requirements which determine whether or not a trustee is non-affiliated on the basis that many organisations covered by these regulations are not legally constituted as companies. We have amended these references in the regulations so that they refer to "undertaking" instead.

**We have amended the draft regulations so that:**

- **the trustees must appoint the chair where the scheme does not already have a chair in place.**
- **schemes do not have to produce a chair's statement from April 6th 2015, if the period covered is less than 3 months, but instead roll that statement up into the next year's version.**
- **the reference to "company" for the purpose of determining non-affiliation in a relevant multi-employer scheme now refers to "undertaking".**

## Chapter Summary

**We have made it explicit that only restrictions in trust deeds and rules are captured by the provisions which ensure trustees are not restricted in their choice of service provider.**

**We have clarified our definition of "professional trustee", to better describe these types of trustees.**

**We have excluded (on a temporary basis until April 2016) from our definition of multi-employer scheme, those schemes established by statute – this will allow us time to find out how many and what types of scheme would fall into this category and whether their governance arrangements are robust enough to meet our policy objectives.**

**We have clarified the provisions on who appoints the chair of trustees, ensured that professional trustees are recognised as directors of incorporated trustees, provided an easement (for the first year only) on the timing of the Chair's Statement, and refer to "undertaking" rather than "company" in the multi-employer independence requirements.**

# Measures to control pension scheme charges 3

## Introduction

1. The March 2014 Command Paper announced a range of measures aimed at controlling the level of charges in workplace pensions which are qualifying schemes. These included capping charges in the default funds of qualifying schemes at 0.75 per cent of funds under management, or an equivalent combination charge, and banning consultancy charges from April 2015, followed by a ban on Active Member Discounts and member-borne adviser commission from April 2016. The Government also said it would review the level of the default fund charge cap in 2017 to see if it should be changed and whether it should be extended to include some or all transaction costs.

2. The October Command Paper set out our detailed policy proposals and consulted on these, as well as the draft regulations which would implement the policies. The draft regulations also provide The Pensions Regulator (TPR) with additional powers to help them regulate trustees' compliance with the new measures. The Financial Conduct Authority (FCA) has consulted on equivalent rules for providers of workplace personal pensions, which they will regulate. Subject to the outcome of that consultation, the charges measures for workplace personal pensions will also come into force from April 2015.

3. This chapter sets out the Government's response to the recent consultation and outlines the changes we have made to the regulations following this exercise. The regulations will be laid before Parliament for their scrutiny alongside the publication of this Government's response.

4. The areas covered in this chapter are:

   - Responsibility for complying with the charges measures
   - Defining member-borne deductions which fall within the cap
   - Defining the default arrangement
   - Transitional arrangements and the default arrangement

- To whom the cap applies
- On what funds the cap applies
- Permissible charge structures
- Assessment of charges
- Opt-in services
- Transfers and decumulation
- Active Member Discounts

## Responsibility for complying with the charges measures

**Consultation question:** Do you have any comments regarding the policy on who should have the duty of compliance with the charges measures?

Do you have any comments about how the draft regulation (regulation 4) meets the policy intention?

5. The October Command Paper explained that we had worked closely with TPR and the FCA to determine whether the legal duty of compliance with the charges measures should sit with employers or trustees and providers. Our aim is to secure a high level of compliance whilst minimising disruption to the roll-out of automatic enrolment and being proportionate in respect of the burden placed on employers, trustees and providers.

6. We proposed that the duty of compliance should sit with trustees and managers in occupational schemes and pension providers in workplace personal pension schemes, as reflected in the draft DWP regulations and FCA rules. We explained that, as their role involves providing and buying-in services for members, they would be best placed to obtain information on costs and charges. In addition, they would be responsible for making any changes to ensure their schemes were compliant with the charges measures. Most respondents agreed with our approach.

   "We feel that it is correct to place the duty on the trustees or managers. We feel that where a trustee or manager offers a qualifying pension scheme they are best placed to ensure that charges are maintained at a level within the cap or take remedial action as appropriate."

   **Friends Life**

7. Those respondents who disagreed with this approach suggested that some trustees and/or pension providers may not know whether they were managing a qualifying scheme. This knowledge is a key factor for successful compliance and we consider that existing legislative requirements, such as regulation 7 of the Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010[10] as well as other requirements outlined in paragraph 11 of the October Command Paper, will mean that trustees and providers should already have this information. Other respondents agreed with this.

   "We agree that the legal duty to comply with the charges measures should rest with trustees and managers in occupational schemes and with pension providers in workplace personal pension schemes. We also agree that trustees and providers should know whether they are operating a qualifying pension scheme."

   **Hargreaves Lansdown**

[10] SI 2010/772

8. Where there is any doubt as to whether a scheme is a qualifying scheme, trustees and providers should take steps to clarify the position with the employer. They may also wish to consider the benefit of amending their contractual arrangements, or scheme rules, to ensure they have this information in future.

9. Having considered all the responses, we still consider that trustees, in occupational schemes, and providers, for workplace personal pensions, should be responsible for ensuring that any qualifying schemes which they offer are compliant with the charges measures. This is set out in regulation 4, for relevant occupational schemes.

**We have not made any changes to the policy on who should have the duty of compliance with the charges measures.**

**Trustees and managers will have this duty in occupational pension schemes.**

## Defining member-borne deductions which fall within the cap

**Consultation question:** Do you have any comments on the policy regarding the member-borne deductions that fall within the cap, and how the draft regulations reflect the policy intention? The exclusions are:

(a) the non-recurring variable transaction costs which are incurred by a scheme when buying, selling, lending and borrowing underlying investments ("transaction costs" definition in regulation 2)

(b) pension sharing and compliance with court orders ("charges" definition in regulation 2)

(c) winding up costs ("winding up costs" definition in regulation 2)

### Transaction costs

10. In the March 2014 Command Paper we indicated that transaction costs would be excluded from the default fund charge cap. We also announced that the Government will consider in 2017 whether some or all of the transaction costs borne by members should be included within the cap.

11. In October we consulted on a principle-based definition of transaction costs as "the costs incurred as a result of the buying, selling, lending and borrowing of investments." The majority of respondents favoured a principle-based definition.

"We further support the approach of not defining a list of transaction costs in regulations and the recognition that full information about all transaction costs may not be initially available to trustees. This appears a pragmatic approach while driving improved transparency in the future."
**Zurich**

12. One respondent argued that individual transaction costs should be set out in regulations.

"It would be helpful if the regulations explicitly stated precisely what costs the Department regards as transaction costs. In that regard, including the [table of costs] excluded from the default fund charge cap on MBD in the regulations would be a positive step. We regard this as a good list of exclusions from the cap."
**Investment Association**

13. Whilst putting the weight of regulation behind a list of transaction costs would arguably provide clarity for the industry, our view is that such an approach will not be sufficiently flexible in the light of changing investment terminology and product innovation, and over time the list could risk excluding costs which, as a matter of policy, should be captured. Including both such a list in regulations, as well as the principle-based definition, could lead the two to diverge over time with industry developments, thereby resulting in less certainty for trustees and service providers over whether a particular cost or charge should be included in the cap.

14. A number of respondents raised other arguments and points about individual charges and transaction costs. These are addressed in turn below. Firstly, several respondents suggested that the position of tax deductions should be re-examined.

"We suggest that tax charges (both scheme and member) are added to the list of exclusions."
**Squire Patton Boggs LLP**

15. However, taxes act as a drag on the performance of members' investments like any other charge, so it is appropriate that, where these taxes relate to scheme and investment administration, they should be included within the cap. The non-exhaustive lists of example costs and charges published in both the March and October 2014 Command Papers made clear that unrecoverable VAT was in scope of the cap, and we do not intend to alter this position.

16. One item in the non-exhaustive list of example costs and charges which caused slight confusion was "fees for non member-initiated switching of funds", defined as being in the cap.

"There will be circumstances in which it will be in members' interests to switch funds, for example where the default fund is consistently under-performing. .. we consider that where it can be demonstrated that switching funds is in the best interests of members while the scheme is ongoing, related charges should also be validly be excluded from the cap."
**Sackers**

17. Trustees will switch members between funds from time to time, whether as a one-off change in the default arrangement, part of rebalancing between assets or as part of a planned transition from more volatile investments to less volatile ones as the member nears retirement. In all these cases, our intention is that the costs which are directly attributable to the buying, selling, lending and borrowing of investments meet the transaction cost definition and are therefore outside the cap. Other fees for non member-initiated switching of funds – for example, those related to advice, research and communications – would fall inside the cap. We have amended the description of this item accordingly in the non-exhaustive list of costs and charges in Annex A.

18. It is also our intention that custody levies which are imposed as a result of the sale, purchase, borrowing or lending of an investment would also constitute a transaction cost. Whilst we recognise that this classification differs from that used by the Ongoing Charges Figure in Undertakings for Collective Investments in Transferable Securities (UCITS) funds, we will consider how this cost could best be disclosed as part of the second phase of transparency measures, on which the Government plans to issue a call for evidence in the Spring.

19. Two respondents queried the inclusion of research costs within the definition of transaction costs.

"We strongly believe that research costs are part of the day-to-day running of a fund and therefore should be included within the charge cap. Furthermore, permitting the exclusion of soft commission from the charge cap effectively lends support to the continuance of the practice of including a range of services in brokerage costs."
**Trades Union Congress**

20. We believe it is appropriate that research costs should be included as a transaction cost, where they are not delivered separately from broking services. In these circumstances they are part-and-parcel of dealing commission, and fall within the definition of costs incurred as a result of buying, selling, lending and borrowing investments. We also note, however, that the range of services, including research, which can be provided as part of dealing commission has been significantly narrowed under FCA rules[11]. These new rules apply to dealing commission on investment management services to many occupational as well as to workplace personal pension schemes

21. Where research costs are not incurred as a result of the buying, selling, lending and borrowing of investments they will not fall within the definition of a transaction cost, and will be covered by the cap. This will be the case where research is paid for via a subscription service, or through ad hoc purchases unrelated to trading.

22. Two respondents also queried the application of the charge cap and the transaction costs definition to property.

"The Property Expense Ratio (PER), which is in addition to the TER, covers a wide range of variable fund costs which are unique to funds with direct property holdings and can be significant at times. Some of these costs are an inevitable feature of direct property investment such as maintenance costs and rental defaults, whereas others such as re-development capital costs are under the control of the fund manager and have a direct bearing on future investment returns. Can all the components of the PER be treated as falling within the definition of transaction costs or otherwise not subject to the cap?"

**Hymans Robertson**

23. Again, the principle-based definition of transaction costs would apply here, for property as for any other investment. This means that the elements of the Property Expense Ratio which are incurred as a result of the buying, selling, lending and borrowing of assets are transaction costs, and would therefore lie outside the cap. This could include letting and lease renewal fees and disposal costs. The classification of specific costs may depend on the particular circumstances but, in line with this definition, we would generally expect that other costs, such as marketing, insurance and property management, would not fall within the definition of 'transaction costs' and would therefore be subject to the cap.

24. The Government recognises that property is a useful diversifier of investment risk, but that the higher costs of administration may limit the proportion which can be held within the default arrangement whilst complying with the charge cap overall. This will also apply to other more expensive asset classes. Nevertheless we consider it appropriate for the charge cap to be neutral with regard to different asset classes, and that any exclusion of expenses connected with particular types of investment could influence investment strategies with potentially unintended consequences. Trustees and fund managers may also consider other options by which they can gain access to investments with higher holding costs, such as through derivatives. Furthermore, schemes will continue to be able to offer members the option to choose different, non-default investment options which will not be subject to the charge cap.

[11] As set out in the FCA's *Conduct of Business Sourcebook (COBS)*, Chapter 11.6, an investment manager can only receive substantive research or execution-related goods and services in return for dealing commissions paid to brokers for the execution of client orders (see: http://www.fshandbook.info/FS/html/FCA/COBS/11/6) – See also Changes to the use of dealing commission rules: feedback to CP13/17 and final rules – http://www.fca.org.uk/static/documents/policy-statements/ps14-07.pdf

25. One respondent also argued that performance fees should be excluded from the cap. However, such fees are not directly connected to transactions – a strategy of ‘buy and hold’ could just as easily lead to a high performance as high volumes of trading – and such an exclusion could undermine the cap by allowing members to be subject to potentially high and uncapped performance fees, with no guarantee that members will benefit overall net of these charges.

26. Finally, there was some confusion amongst two respondents about the description of costs relating to stock lending and foreign exchange. In the Government’s view, the draft regulations have the effect that the costs of such activities are excluded from the cap, irrespective of how the proceeds from these activities are shared with members. We have again amended the description of this line item in Annex A to make this clearer (although please note that this list does not form part of the regulations to be laid before Parliament).

**We have not amended the definition of transaction costs. We have improved the clarity of some items in the list of examples of costs and charges which we would expect to be included in and excluded from the cap, but these do not form part of the regulations.**

### Other costs excluded from the cap

27. In our October consultation we also proposed that charges in relation to earmarking and pension sharing cases should be excluded from the cap. This was because they were quite different in nature from the charges associated with general scheme and investment administration.

28. Most respondents agreed with this proposal, and only one disagreed, arguing that earmarking and pension sharing cases could be very cheaply processed in money purchase schemes, given that the transfer value of the fund is known at all times. They therefore suggested that these costs should be subject to the cap.

29. We also consulted on excluding winding up costs from the charge cap. This was in order to mitigate any risk of a situation arising whereby a scheme could not comply with the cap in the longer term, but was unable to proceed to wind-up because the costs of doing so would exceed the cap.

30. Again, the majority of respondents who expressed an opinion supported this proposal. Two respondents believed that the definition of winding up costs in regulation 2 was too narrowly drawn, and identified items which they believed had been wrongly excluded – these included the costs of data reconciliation, resolution of any disputes and expenses incurred by trustees. However, it was not our intention to provide an exhaustive list of winding up costs. The definition in regulation 2 makes clear that winding up costs include, but are not limited to, the items listed. Regarding the suggestion that the costs of data reconciliation could be associated with scheme wind up and should therefore be excluded from the cap, we do not consider that this is the case. Data cleansing and reconciliation should be carried out as a matter of course and accurate data is necessary to comply with the requirement in the new minimum governance standards to process core financial transactions promptly and accurately.

31. One other response suggested that the definition was too widely drawn.

“Although we agree that winding up costs should be excluded from the definition of member borne deductions, it is possible this exclusion could be wider than intended. For example, an additional annual charge could be made to cover the costs of any future scheme wind up.”

**Hargreaves Lansdown**

32. It is not our intention that a separate charge could be levied to cover the eventuality of a potential scheme wind up. Our intention is that only the costs which are specifically attributable to the process of winding up a scheme are excluded from the cap. This could, for instance, include initial legal advice to the trustees, or communicating to members that a decision to wind up the scheme has been taken.

33. As part of its 2017 review of the level of the charge cap, the Government will also review these exclusions and the way in which they are defined to ensure that members are protected as intended.

**We have not made any amendment to the existing exclusions of earmarking, pension sharing cases and winding up costs.**

## Defining the default arrangement

**Consultation question:** Do you agree with the policy on which the draft regulations are based (see regulation 3) – to capture as many workers as possible who made no active or informed choice about their investment strategy, whilst also minimising the risk of capping funds where members made an active choice?

### Background

34. Our October Command Paper set out the twin principles behind the definition of the default arrangement – capturing as many workers as possible who did not make an active or fully informed decision about their investment strategy, whilst also minimising the risk of capping funds where members did make an active choice.

35. We proposed that the default arrangement is defined at employer level, and that the default arrangement needed to be used by a qualifying scheme in relation to one or more jobholders of an employer, at any date on or after 6 April 2015 (or the employer's staging date, if later). The arrangement does not need to be used to meet automatic enrolment duties in relation to each individual member.

36. We also proposed that where an arrangement is a default for a particular employer, then all members of that arrangement who are or have been employees of the employer will continue to be covered by the charge cap as long as they remain invested in the default arrangement, except for those who cease contributing before April 2015, or the employer's staging date, if later, and do not resume contributing. Where an arrangement is designated as a default for a particular employer within a multi-employer scheme, this does not mean that this arrangement is necessarily a default for another employer using that multi-employer scheme (unless that same arrangement is separately deemed a default for that employer under regulation 3).

37. The default arrangement may be identified through three tests (see regulation 3). These are explained in full in the October Command Paper, pages 53-56.

38. A substantial majority of respondents were in broad agreement with the proposed approach.

"We agree with the policy of limiting the charges of those who have made no active choice and believe that the initial 80% test will not disturb the choices of members making an active investment choice. "

**Standard Life**

39. Consultation respondents did however have a variety of questions about elements of the three default arrangement tests which we address below.

### Arrangements where members do not make an active choice

40. Several respondents to the consultation expressed concern that the first test would inadvertently catch arrangements which did not require the member to make a choice about where their contributions were directed, but were not used by an employer to meet their automatic enrolment obligations.

"We believe the definition of 'relevant scheme' is too wide in that it encompasses default arrangements that may have no use in auto-enrolment compliance (for example a money purchase section or AVC section linked to a DB qualifying arrangement where it is only the DB element that is used to satisfy the employer's auto-enrolment obligations)."

**Aon Hewitt**

41. It was not our intention for defined benefit (DB) schemes which offer money purchase benefits through Additional Voluntary Contributions (AVCs) to be caught by the definition of a 'default arrangement'. To achieve this, we have amended the wording in regulation 3(1)(a) so that, in order to be a default arrangement, the arrangement has to be used by a qualifying scheme "which is a relevant scheme" in relation to one or more jobholders. This means that where a scheme offers DB and money purchase benefits, only the money purchase benefits are considered for the purpose of the regulations. Because the Additional Voluntary Contributions (AVCs) are not being used by an employer to meet their automatic enrolment duties – the defined benefit element fulfils this purpose – the money purchase AVCs should not therefore be identified as a default subject to the cap when they are the only money purchase benefits in a scheme.

42. Similarly where a member's AVCs are invested in an entirely separate scheme which is not used as a qualifying scheme for any jobholder of their employer, then they would also not be caught by regulation 3(1)(a). This is because the AVC arrangement would again not be used to meet the employer's automatic enrolment duties under the Pensions Act 2008 in respect of any workers. However, where the AVCs are made to an arrangement which is being used to meet the employer's automatic enrolment duties in respect of other workers (for example, in a scheme where longer-serving staff are accruing Defined Benefits, whilst newer employees are accruing money purchase benefits), then they could be capped – see the following section.

### Who should be included in the 80% test

43. Several respondents to the consultation queried which members should be included for the purposes of the 80% test. We have amended the definition of contributing members in regulation 2 to make clear that only members who are accruing money purchase benefits should be considered.

44. This means that members of a qualifying scheme who are only accruing non-money purchase benefits (for example, members who are only members of a final salary pension scheme) are not considered as part of the 80% test.

45. An additional concern here also related to the treatment of AVCs.

"It appears to us that the draft regulations require that, for the purposes of the 80% test, DB members paying AVCs on 6 April 2015 should be lumped together with DC members who had been required to make a choice and who were contributing on that date. This will make it less likely that the 80% test is satisfied in cases where the AVC investment options differ from the DC investment options."

**Towers Watson**

46. We agree that the outcome of the test could be significantly skewed given that members who chose to pay AVCs are potentially more likely to have made an active and informed choice of investment vehicle. Funds which may have met the 80% test when only members accruing money purchase benefits were considered may fail to be identified as a default, due to the diluting effect of members invested in AVCs. It could also increase the risk of funds which members made an active and informed choice to invest in being misidentified as a default.

47. To address this issue, we have changed the definition of contributing member in regulation 3(9) so that, for the purposes of regulation 3, it does not include a member whose contributions are solely AVCs. These members are therefore excluded from the 80% test.

48. Trustees should have ready access to the necessary records to identify whether a member is also accruing non money purchase benefits, and therefore whether the member's contributions to a non-money purchase benefit are AVCs.

49. As indicated in paragraph 42 above there is, however, still one circumstance in which AVCs could be subject to the default fund charge cap. This is where a particular arrangement is, first, used by a qualifying scheme to fulfil an employer's automatic enrolment duties in respect of at least one employee, and second, meets one of the three tests in regulation 3(2). Where this happens, workers of that employer who have chosen to make AVCs which are invested in the same arrangement would also be protected by the cap, in line with regulations 3(5) and 4(2). This meets the fundamental test of fairness set out in our October Command Paper, that members of the same scheme in the same organisation in the same arrangement should pay the same charges.

50. Several respondents have raised concerns that trustees of unbundled schemes which, apart from AVCs, only offer Defined Benefits, may have little opportunity to offer AVCs within the cap. This may arise if the number of contributing members is small, with little prospect of building up substantial funds under management. Capping such arrangements would result in trustees needing to cease offering AVCs altogether. The narrow circumstances outlined above in which AVCs will be capped should mean this is a very limited risk.

**Example**

Clare joined employer EiggZample's pension scheme in 2010, before automatic enrolment began. EiggZample had recently closed its final salary option to new joiners, and instead offered new employees the opportunity to join a money purchase part of the scheme. Clare was presented with a list of three options from which she had to choose between funds X, Y or Z. She selected the first on the list – Fund X – and signed and returned the membership form.

Some members accruing defined benefits in the final salary option also make money purchase AVCs – they were required to make a choice between the same funds X, Y and Z invested in the same scheme.

Sam was automatically enrolled by EiggZample two years later, in 2012, and her contributions were directed into Fund Y without her making any active choice.

When the default fund charge cap is introduced in April 2015, Fund Y will be identified as one of the employer's default arrangements, as Sam's funds are directed into it without her exercising any choice.

To determine whether any other funds will also be identified as a default for that employer, the trustees should first identify all the EiggZample employees who are actively contributing on the relevant date, and were required to make a choice, excluding all the members who are not accruing money purchase benefits and all the members whose only contributions towards money purchase benefits are AVCs. If for example this leaves 150 members, and 120 or more of them are contributing to Fund X, then Fund X will be designated as a default. This is because it meets the 80% test in regulation 3(2)(b).

If this is so, the charge cap will also apply any EiggZample employees who are making AVCs to Fund X or to Fund Y. It will also apply to any other EiggZample employees who are active members of the scheme and were not required to make a choice, but actively decided to invest in Fund X or Fund Y. The cap will not, however, apply to someone making AVCs to Fund Z.

If Clare were to subsequently actively choose to join Fund Y the charge cap will apply to her as well. This meets the principle outlined above in paragraph 36, of minimising differences in treatment between colleagues.

## Other concerns with the 80% test

51. Respondents also had a variety of concerns about the 80% tests used in regulation 3(2)(b) and 3(2)(c). Some respondents believed that it could be difficult for trustees to obtain the information required to carry out the assessment for each individual employer.

"The information necessary to carry out this assessment may not be readily available to the trustees and it could be time consuming (and costly) to do so. It would be easier for trustees to assess their scheme against a simpler measure, looking at members across the scheme as a whole instead."

**Sackers**

52. Whilst we accept that there may be work involved in carrying out the assessment at employer level, trustees should have records which indicate the funds into which members' contributions are being allocated. We would also expect trustees to have records which would give an indication of when members joined the scheme (this is a common data item, as set out in TPR's 2010 record keeping guidance and referenced in TPR's Code of practice no. 13, Governance and administration of occupational defined contribution trust-based pension schemes), and whether at the time the trustees required members to make an active choice.

53. In contrast, a scheme-wide approach would not meet the principles outlined above of capturing as many members as possible who did not make an active choice. This is because employers with long-standing pension provision in place are likely to have used a variety of different funds over time and may have used the services of advisers, who directed members to use particular funds. An assessment at 'connected employer' level would be similarly inappropriate, as trustees may not always be aware that employers separately enrolling staff were legally connected.

54. Some respondents felt that there were particular problems associated with applying the test to small employers.

"The rules would not work effectively for very small schemes. In such cases, whether the member did make a decision on investments should be dominant over the presumption that, if a high proportion of members are in the same fund, that no such decisions were made."
**Society of Pension Professionals**

55. We have separately addressed any unintended effects from including single member schemes within the definition of a relevant occupational scheme subject to the regulations (see chapter 1 and regulation 2(2)). It is true that with smaller employers, a smaller number of scheme members would be required to choose a given fund for an arrangement to meet the 80% threshold. However, the Government should protect savers who work for employers of all sizes. An approach which involved disapplying the second and third tests for employers under a certain size threshold would undermine this principle.

56. If providers are unable to continue to offer workers of a particular employer an arrangement within the cap, they may use the provision in regulation 3(3) to ensure that members have actively agreed to pay in excess of 0.75%, or an equivalent combination charge.

57. In any case, the staging of the roll-out of automatic enrolment means that smaller schemes that may be in this situation are not likely to have reached the staging date of their employer (by April 2015, only employers with 50 employees will be subject to the automatic enrolment duties under the Pensions Act 2008) and so will have additional time to prepare for the introduction of the charge cap.

58. A third concern was that the flow of members into and out of the scheme would mean that trustees are unable to confirm which funds are caught by the 80% test until the staging date.

"Where we know that an active choice fund is charging above the cap... we won't know whether this will be deemed a default or not until the day the cap bites. This gives no time for a switch to a cap appropriate fund or for the advisers to communicate with their customers to see if they want to move or not."
**Royal London**

59. We expect that this issue will arise for only a limited proportion of employers, who are likely to be small employers with low staff numbers, which would mean that the proportion of scheme members contributing to a particular arrangement was particularly sensitive to small fluctuations. Nevertheless, trustees have a variety of options under the regulations. They may close the arrangement to new workers of the employer to reduce the risk of reaching the 80% threshold, or close it to future contributions by all workers of the employer, in which case it could not be designated a default subject to the cap. Alternatively, they may again use the arrangements in regulation 3(3) to move members to a new charge cap compliant default unless members actively choose to remain in the arrangement.

60. A careful examination of the funds to which active members of the schemes are contributing, combined with one or more of these actions, should give trustees confidence that they will not find any arrangement unexpectedly being designated a default for a particular employer.

**Ongoing monitoring of the 80% test**

61. Respondents had a number of concerns about the third default fund test, chiefly around the potentially onerous nature of this requirement. We should emphasise that this test was designed to cater for a specific situation where the trustees continue to use a scheme which does not have a true default arrangement and requires the scheme member to make an active choice as to where their contributions are invested.

62. This might occur, for example, where an employer contract-joins new employees before they become jobholders eligible to become automatically enrolled, and requires them to choose an arrangement at that point.

63. We have realised, however, that this provision in the draft regulations did not clearly reflect the policy intention, as set out in the consultation document, that an ongoing test is only required in respect of arrangements which first received contributions from workers after the relevant date. We have amended the provision to clarify this. This means that trustees of schemes which require members to make an active choice will not need to monitor the distribution of members across all their arrangements, as long as they only offer arrangements which have already received contributions from workers of the relevant employer. It is only new arrangements which first receive contributions after the relevant date that this will apply to.

64. If, however, trustees still have concerns about the onerous nature of the test, they should instead consider providing a 'true' default to all new joiners, so that they do not need to make an active choice of where their contributions are invested. Where members continue to be required to choose an arrangement , we expect that trustees will provide sufficient information to enable members to make an informed choice.

**We have amended the definition of contributing members (regulation 2) to make clear that only members who are accruing money purchase benefits should be considered.**

**We have also changed the definition of contributing member for the purposes of regulation 3, so that a member whose only contributions to money purchase benefits are AVCs are excluded from the 80% test.**

**We have amended the text of regulation relating to ongoing monitoring of the 80% test (regulation 3(2)(c)). We have not changed the policy.**

## Transitional arrangements and the default arrangement

**Consultation question:** Do you agree that the draft regulations (regulation 3(3)) should allow members who have made a recent active choice to remain in an arrangement which is not subject to the charge cap?

Is the 3 month time period allowed reasonable?

65. In the October Command Paper, we proposed that if, at any time in the three month period ending with the date that the charge cap applies to members of the scheme ('the relevant date'), a new charge compliant default is offered to all members who are actively contributing to this arrangement, but some workers agree in writing to remain in their existing arrangement, then the current arrangement would not be subject to the cap.

66. As appropriate safeguards, we also proposed that trustees and providers would need to be able to demonstrate that workers made an active choice and acknowledged that in choosing to remain with their current arrangement they would not be protected by the default fund charge cap.

67. Almost all respondents to our consultation supported the provision of this option to allow members to actively choose to remain in an uncapped arrangement. A significant number argued that the period during which members ought to be able to re-affirm their desire to remain invested in their current arrangement should be longer than three months as this would be of use to those staging later in the automatic enrolment roll-out. Six or twelve months were common suggestions.

"We suspect that members would not be happy if their active investment choice made as recently as 4 months ago was over-turned – especially if they are relatively close to retirement such that the costs and potential out-of-market risks of transitioning between funds outweighs the saving from moving to a charge capped fund. We believe a 12 month period would be more acceptable to members."
**Hymans Robertson**

68. One stakeholder argued that there should be a minimum period, and highlighted differences from the FCA's approach to workplace personal pension schemes.

"We would suggest that this should be changed to say that communication should take place at least 1 month prior to the relevant date. [This] provides a minimum notice period for members to opt out of the change to their default..... The FCA, in their proposed changes to their Conduct of Business Sourcebook (COBS), have not included reference to the 3 month window but have simply stated that the changes must take place prior to the scheme becoming a qualifying scheme."
**Friends Life**

69. A small minority of respondents argued that trustees should be able to continue to exercise this option for some months after the relevant date. We do not intend to adopt this approach. Since the announcement in March 2014 that we would legislate to introduce a default fund charge cap from April 2015, trustees will have been considering how their scheme(s) will be impacted and options available to adapt to the introduction of the cap. Where capacity constraints do not allow time to offer members contributing to the default arrangement the choice to remain in a fund charging in excess of the cap, trustees should instead divert member contributions to a charge compliant arrangement in readiness for April 2015. They may subsequently allow members the choice to move back to the previous arrangement.

70. On further consideration we have decided to accept the proposal that there should be no time limit in regulation 3(3) for the period in which members can make an active choice to remain invested in a particular arrangement when a charge compliant default is offered to them. We have therefore removed the 3 month provision. This also aligns the regulation with the FCA draft rules for workplace personal pensions.

71. We consider that this will not affect the level of member protection afforded by this provision, or allow trustees to use a past decision by a member to contribute to an arrangement, because regulation 3(4) is specific in how this option must be communicated to members. For instance, it requires that the worker's agreement to remain in an uncapped arrangement must include an acknowledgement that the charges may be higher than those permitted under the charge cap. However we will monitor the communications issued to members, to ensure savers are protected as intended, in line with the suggestions of consultation respondents.

"The communication to members giving them the option of switching to a charge cap compliant arrangement will need to be carefully worded so that it is not construed as giving financial advice."
**Law Society of Scotland**

72. We do not intend to introduce a minimum period in regulation 3(3). We do not believe there is any significant risk of periods much shorter than one month being used by trustees and providers as a pretext to divert members' contributions to a new arrangement without agreement, as scheme rules and contracts already generally permit this.

73. Two respondents suggested that the switch to a charge compliant default should in some circumstances be by positive affirmation.

"There may also be significant member detriment arising, where the 'forced' redirection has led to the loss of particular benefits, e.g. under a with-profits arrangement, or where loyalty bonuses and guarantees would have applied. We believe that the best approach to communication, to minimise such member detriment, is to positively ask such members of schemes, with valuable benefits, whether or not they wish to re-direct their future contributions."
**Prudential**

74. We believe that provisions elsewhere in the regulations mitigate the risks of member detriment. In particular, the charge cap is limited to money purchase benefits without a third party promise, members may choose to opt-in to additional services at an additional cost under regulation 9, and paragraphs 129-146 of this chapter set out provisions for other valuable services and opt-in benefits. Particularly in the context of automatic enrolment into pension saving, it is not appropriate that members should be required to opt out of services which they may not value in order to be protected by the cap.

75. Some respondents queried whether the communications could prevent members giving agreement over the web or by email. We can confirm that these are permissible, subject to the definition of "writing" in regulation 2.

76. Finally, a couple of respondents queried what would happen to members who had not originally made an active choice about where their contributions would be directed when they joined the scheme (and therefore whose arrangement was to be designated a default under regulation 3(2)(a)) and who, prior to the relevant date, saw their contributions diverted to a new charge-compliant arrangement.

77. In this circumstance, the new arrangement would be caught by regulation 3(2)(a) and designated a default arrangement for that employer. Furthermore, as long as the contributions of all members who did not make an active choice to continue to invest in the old arrangement were diverted to the new arrangement, there would be no risk of the old arrangement being

designated as a default either under regulation 3(2)(a) (as they were not contributing to the arrangement without making a choice), or under regulation 3(2)(b) (as they were also not required to make a choice about where their contributions were directed)..

78. This means that when trustees divert the contributions of members who were not originally required to make an active choice to a new arrangement, irrespective of whether they offer those members an option to actively choose to remain in their old arrangement, they do not need to rely on the provisions in regulation 3(3). We have therefore drafted this regulation in such a way that it does not apply to regulation 3(2)(a). On the other hand, if the trustees choose to only give such members an option to divert their contributions to a new 'default', (rather than diverting their contributions unless they actively choose to opt-out) the old arrangement would be designated as a default unless every such member opted to transfer – because otherwise some members would still be contributing to the old arrangement without needing to make an active choice. Similarly, if trustees only redirected the contributions of some members to a new arrangement, so that other members who had not made an active choice were still contributing to the old arrangement– it would again be designated as a default for that employer.

**We have removed the maximum time limit ahead of the relevant date in which the opt-in regulation 3(3) applies.**

## To whom the cap applies

**Consultation question:** Consultation question: Do you have any comments on the policy about the members to whom the cap applies?

Do you have any comments about how the draft regulations meet the policy intention?

79. In our October Command Paper, we proposed that the charge cap would apply to all members (both workers and jobholders) of relevant qualifying schemes who make at least one contribution to the default arrangement at any point after the relevant date. The relevant date is the point at which the charge cap applies to a scheme, which will be either 6 April 2015 or the employer's staging date, if later. The draft regulations published in October already had the effect that, where members' contributions were received by the scheme's trustees on the relevant date itself, they would be protected by the cap from that date. However we received a small number of queries on this point, so we have amended regulation 4(2)(b) to make it absolutely clear.

80. We also proposed that the cap would continue to apply to these members for as long as they have funds invested in the default arrangement, regardless of whether they leave their employer or cease contributions and become deferred.

81. Many respondents supported these proposals and agreed that they struck the right balance between protecting scheme members and supporting the roll-out of automatic enrolment by minimising disruption to schemes and providers.

"It is reasonable for consumers to expect that their funds will be protected by the charge cap if they make a contribution from their employers' staging date or April 6th 2015, whichever is later. We agree with the policy intention that the cap should continue to apply as long as they have monies invested in this fund."

**Association of British Insurers**

82. Others thought that this scope should be extended to include all members of default arrangements, including those who have ceased contributing before the charge cap applies to an employer's scheme. They argued that there was potential for higher charges on previously deferred members to subsidise lower charges on members who are actively contributing at the relevant date.

"This policy is insufficiently robust in protecting deferred members [...]. This risks stranding large amounts of assets in uncapped funds belonging to those who haven't made an active fund choice."
**Trades Union Congress**

83. Others thought that this was unlikely due to administrative complexity of distinguishing between different members and that schemes would either cap the charges of all members of the default arrangement or, if it could not be made compliant, re-direct future contributions to a new, compliant arrangement ahead of April.

"The principle of applying the requirements only for those who have active membership after April 2015 will result in the need for segregation amongst the membership if the cap is not also applied to pre-April 2015 leavers. In practice most schemes will not wish to do this."
**Capita**

84. Many respondents welcomed the suggestion that trustees and providers should give deferred members, as well as those in closed schemes and arrangements that are not subject to the cap, the option to transfer their funds to a capped default arrangement. Some suggested that this should be a statutory requirement.

"Without any [legislative] requirement underpinning this expectation, there is a risk that swathes of members will be left in high charging legacy schemes without being informed of their options."
**Eversheds**

85. However, others pointed to potential disadvantages to requiring trustees to transfer members' funds, such as the potential loss of accrued benefits, for example loyalty bonuses. They therefore suggested that trustees and, in contract-based schemes, Independent Governance Committees (IGCs) should consider what course of action would be in members' interests, taking into account their individual circumstances, such as the level of costs and charges, member characteristics and the presence of additional benefits.

"We believe this is a job for the IGCs to decide on what should be done with deferred members and closed schemes. It might not be in the interests of the customers to be offered a new contract in case they inadvertently lose benefits or crystallise penalties."
**Royal London**

86. In view of the range of responses received, we continue to consider that the application of the default fund charge cap in the draft regulations is appropriate and the regulations laid before Parliament reflect this. We recognise that this may result in some members who have become deferred in advance of the charge cap applying to their scheme not being subject to the cap. However, trustees and IGCs will have an on-going duty to consider the levels of charges borne by both deferred and active members of schemes and to consider whether they are receiving value for money. Moreover, the introduction of the Automatic Transfers system, which the Government intends to introduce from Autumn 2016, will mean that smaller pots created since the beginning of automatic enrolment will move into the member's new qualifying scheme and be subject to the charge cap.

**We have not made any changes to the policy concerning to whom the cap applies.**

**We have amended the regulations to clarify that the cap applies from the date that the first contribution is received, including contributions received on the relevant date.**

## On what funds the cap applies

**Consultation question:** Do you have any comments on the policy intention of imposing the cap on the total fund of the member and not just on contributions made after the relevant date?

87. In our October Command Paper, we proposed that the charge cap would apply to all of the member's funds in any arrangements identified as a default, irrespective of whether these contributions were made prior to or after the introduction of the cap – subject to the requirements set out in paragraph 79 above.

88. Of the respondents who answered this question, the vast majority supported this approach.

"We support the simplicity approach of applying the cap to the whole of a member's default fund assets, rather than just those assets derived from contributions invested after next April. We would expect that trustees governing default funds with charges in excess of the new cap are already well down the road of identifying the implications."
**Dalriada Trustees**

89. A few respondents suggested that trustees should have the option of whether to apply the cap to the whole pot or just to contributions made after the date that the cap applies.

"It seems unfair for new legislation to impose obligations that have retrospective effect. Equally, however, some schemes may prefer not to have the administrative burden of identifying pre- and post-implementation 'pots'."
**Association of Pension Lawyers**

90. Other respondents have, however, pointed out that trustees effectively have this choice already.

"I agree with the proposal to impose the cap on the total fund of the member and not just on contributions made after the relevant date. However, the regulations will not achieve this objective unless the DWP also closes the loophole in the regulations which allows pension providers to set up new qualifying schemes for contributions after the 1st April 2015 to stop the charge cap applying to all contributions before that date."
**Dominic Lindley**

91. We do not view this option as a loophole. It is important that trustees and providers are able to take action to close arrangements to future contributions where they cannot make them compliant with the cap. However, where the arrangement can be made compliant and continues to be used as a default subject to the cap, it is fair that all funds within that arrangement are capped, including those accumulated from contributions made prior to the application of the cap.

92. In conclusion we continue to believe that the proposed approach will minimise burdens on trustees, providers and regulators to confirm compliance, whilst offering the greatest protection to members.

**We have not made any amendments to the policy on the funds to which the cap applies – where the cap applies to a default arrangement, it will apply to the total fund of the member invested in that arrangement.**

## Permissible charge structures

**Consultation question:** Do you have any comments on prohibiting charge structures other than those set out in regulation 5?

Do you have any comments on limiting the opportunities for altering charging structures as described above, whilst avoiding locking schemes into particular charging structures indefinitely?

93. In our October consultation we reiterated that our intention was to permit only single or dual charging structures. The permitted charging structures were:

- a single annual charge of 0.75 per cent of funds under management or lower (see regulation 5(2));
- a combination of a percentage contribution charge plus a percentage funds under management charge (see regulation 5(3)(a)); and
- a combination of a flat fee plus a percentage funds under management charge (see regulation 5(3)(b)).

94. Whilst dual combination charge structures can help support market dynamics by allowing new entrants to raise capital sooner, we argued that permitting a wider range of charging structures, whether temporarily or permanently, would undermine the existing trend, since the introduction of Stakeholder Pensions in 2001, towards simpler charges and make market-wide comparisons more difficult.

95. This is because multiple charge structures can result in a wide range of different outcomes for scheme members, depending on personal circumstances and factors such as length of time saving and contribution levels. For this reason, it can be difficult to predict the effective charge level that an individual will experience. Allowing a wider variety of multiple charging structures would therefore inhibit the ability of employers and savers to make comparisons between schemes.

96. Again, of the respondents to this question a substantial majority supported this approach. Of the respondents who disagreed, there was a diversity of views, with some arguing that the approach was too restrictive, whilst others suggested it was too lax.

“The range of acceptable charging structures is not wide enough to encompass a number of pre-existing products which could give the same RIY as the 0.75% cap but do not have the same simple, more modern, take on charges. This goes against the Government’s original stated intention to allow existing good quality schemes to be qualifying schemes.”
**Aviva**

“We would have preferred the DWP to pursue this policy the other way round: by standardising charges in a single form before capping them. This would have enabled comparison between providers and would ultimately have made the charge cap easier to apply and less contentious. However, we appreciate the Government’s reasons for capping charges without full standardisation, and would support efforts to fully standardise charges in the future.”
**The People’s Pension**

97. Most respondents suggested that the overall the balance was right.

"While limiting the number of charge types and nature thereof may cause some transitional friction for the industry we do now believe this is the right approach to adopt. It could be argued that this may hamper price innovation but for automatic enrolment schemes it is not entirely clear why a multiplicity of charges could lead to better consumer outcomes in a way that could be explained clearly to the target consumer group."

**Royal London**

98. Trustees of qualifying schemes will therefore, as previously proposed, need to ensure that the charges levied on all members contributing to the default arrangement are one of the three permitted charge structures set out in regulation 5.

99. One respondent highlighted the fact that flat fee charging structures could potentially erode a member's funds to zero, in the situation where they made low levels of contributions for a relatively short period of time. We recognise that this is a possible impact of flat fee charge structures and expect that those parties running schemes, or choosing them on behalf of their workforce, will consider the profile of scheme members in choosing an appropriate charge structures. They may wish to consider making provision in their charging structure to reduce or drop the fixed fee where appropriate, such as below a certain pot size. We will also continue to monitor the impact of different charge structures, in case further changes are needed.

100. In our March 2014 Command Paper we noted concerns that trustees and providers may consider flipping their charge structures between single and combination charges for financial benefit. We recognised that such frequent or unpredictable switching of charge structures could lead to member detriment. However, we also recognised that it would be unreasonable to lock providers in to using a particular charge structure for the whole of a member's accumulation phase.

101. Therefore, in our October Command Paper we proposed that trustees would only be permitted to change their charging structure at the end of each charges year (see regulation 5(4)). Of the respondents to this question, again most supported the proposed approach. One respondent spelled out in detail the risks to members from 'flipping' between charge structures.

"The restriction only applies for a charges year, but the savings are meant to be invested under the trust for decades..... A single annual management charge will necessarily be small with small funds in the early years, but will become significant as the fund grows. In contrast, a contribution charge takes a higher proportion of the fund in the early years, but becomes better value for money in later years. The ability to switch from a combination charge in the early years to a single annual management charge in later years could be an invitation to arbitrage."

**Capita**

102. Some respondents who disagreed with the proposal believe that the approach could limit the opportunity to alter the level of charges within a particular charge structure, for example as a result of changing funds in a lifestyle fund. We can confirm that this is not the case – during a given charge structure, trustees can still alter the level of charges provided the charges imposed on each member over that charges year are 0.75 per cent of funds under management or less (or an equivalent combination charge, pro-rated as appropriate), when assessed using either regulation 7 or 8.

103. A few suggested that greater latitude to alter the charge structure could be desirable in some instances. Amongst the examples cited were alterations forced on the trustees or manager as a result of changes made by the investment provider, a change of default arrangement, a decision by an employer to pay a fee to subsidise the charges for active members, or other exceptional circumstances.

104. In deciding whether more flexibility in the proposed regulations is necessary, we have weighed up the likelihood of these situations arising and necessitating an immediate change in charge structure, as well as the risk of such a change leading to member detriment.

105. Having considered these situations we do not believe a change in the regulations is justified. To take one of the contingencies raised, for instance, an employer who wished to subsidise charges of active members could do this in any charges year without affecting the charge structure, because this would not be a member-borne charge (see paragraph 165 below for further detail on this point). Finally the adjustment measures at regulation 10, covered in Chapter 4, already provides for exceptional circumstances arising.

106. In contrast to these suggestions, most respondents felt that the proposed policy was an appropriate way of addressing the 'flipping' issue.

"Employees should be able to understand charges in order to make decisions ... and be sure that those charges will apply for a period of time. We believe the legislation arrives at the right balance between this aim and the need to allow trustees and managers flexibility to introduce a new structure where this is required in the interests of the membership."
**Friends Life**

107. We have therefore concluded that, on balance, no relaxation of the restrictions on changing charge structure is required. Government and regulators will continue to monitor use of the provision in regulation 5(4) to ensure that members are protected as intended.

**We have not made any amendments to the proposed policy on permissible charge structures. Only single or dual charge structures will be permitted.**

**We have not made any amendments to the proposed policy on changing charge structures. Changes in charge structure will only permitted at the end of a charges year.**

## Assessment of charges

**Consultation question:** Do you have any comments on the policy described above in relation to the valuation of the member's fund and the period over which the charge cap applies?

And do you have any comments on how the draft regulations reflect that policy (regulation 7)?

108. In our October Command Paper we made clear that schemes should comply with the cap at individual member level, not fund level, so that no-one will experience charges in excess of the cap. Our intention in the draft regulation on assessment of charges was to set out a framework for measuring the maximum charge level permitted. The regulations were designed to allow flexibility in the frequency with which the fund value is measured – schemes may choose 'reference points' at regular intervals which must be at least quarterly. The average of the fund values at these reference points, when multiplied by the relevant percentage (0.75% in the case of a single charge scheme), is the maximum charge which may be imposed on the member.

109. Many of the respondents who answered this question supported the approach.

"The regulations allow the significant variance in charging structures to incorporate the charge cap while at the same time offering scheme members sufficient protection."
**Institute and Faculty of Actuaries**

110. However, there were some concerns that the approach was still too prescriptive. Two respondents suggested that less frequent assessment should be permitted. However basing assessment on, for example, just one reference point per year would tend to create a situation in which the maximum charges were based on the fund value later in the charges year when it would tend to be highest. This would in turn result in the member being exposed to a higher nominal charge.

111. Several respondents raised concerns about the application of the charge assessment model to schemes which used a method of charging a percentage charge combined with a regular rebate.

"We believe that further flexibility should be provided to permit those providers who offer structures such as daily deductions through unit pricing above 75 basis points and provide a rebate (usually monthly) for the sum above the cap. These types of scheme can provide good value to members and would meet the policy intention."
**Association of British Insurers**

112. A few respondents also raised concerns about the impact of the proposed method on default arrangements consisting of more than one fund.

"This may mean reducing exposure to long-term investments which are going through a temporary fall in value, only because they have a lower management charge than a better performing fund. Alternatively it could force a reduction in the exposure of an over-performing fund, only because it has a higher management charge than other funds within the portfolio."
**St James's Place**

113. Where the default is a blend of funds, the cap will apply to the arrangement overall, rather than to each of the individual funds within the arrangement. This means that schemes will need to take care to rebalance the allocation to the underlying funds to ensure that, if a higher charging constituent of the arrangement grows at a faster rate, the arrangement as a whole does not exceed the cap.

114. Other respondents identified that fluctuating fund values could also cause problems for trustees, especially those setting a charge close to the cap.

"It is possible that some distortions could arise. As an example, consider a fund that charges the fee monthly, but uses the average of the quarterly values of the member's pot to calculate the value of the applicable cap. If in the final month of the year the fund value plummets this would cause an otherwise compliant scheme to breach the cap."
**Investment Association**

115. We have considered all of these points and recognise that the impact of the proposed method of assessing charges, particularly on schemes which use a charging mechanism involving rebates, or with blended funds, are legitimate concerns. With this in mind, we have provided an additional mechanism by which trustees may verify charge cap compliance. This alternative 'prospective' method of assessment is set out at regulation 8, and explained below.

116. The prospective method of assessment and the current ('retrospective') method have many features in common. Charge compliance still takes place at a member level, and rests on ensuring that the charges levied on the member, expressed as a percentage of the average funds under management recorded at regularly spaced reference points no more than 3 months apart, do not exceed the 0.75% cap, or equivalent combination charge. Moreover, specific provision is made for the situation in which a member is not invested for any reference points.

117. Where the prospective and retrospective methods differ is in the values used for the funds under management in the assessment. Under the retrospective method, compliance is determined at the end of the charges year based on the actual value of funds under management for each individual member. Many schemes will continue to prefer to verify compliance with the charge cap in this way, especially if they charge on an ad hoc basis as and when invoices arrive.

118. For other schemes, which rely on regular deductions to pay all administration charges, or regular deductions combined with rebates, it may be more straightforward to use the prospective method. In effect, this allows the scheme to certify that its charging regime – by which we mean a standardised charging system under which the level and timing of the charges and any rebates are applied, and the basis on which these are calculated – complies with the charge cap.

119. To comply through this method, the trustees will need to verify that, based on a member's start and finish date and discounting any changes in fund value, the maximum charge for the year under the charging regime to be used would not exceed the cap. Once they have assured themselves that this is the case, they will not need to continue to monitor the charges deducted, provided they continue to use the same, compliant charging regime. The prospective method also needs to ensure that, given the joining date and leaving date for each individual member, and the funds under management at the earliest point in the charges year in which they are invested, they still comply with the cap.

120. A significant difference between the prospective and retrospective method is that certifying the compliance of the charges regime to be used in advance via the prospective method allows the scheme to ignore fluctuations in fund value and member deposits and withdrawals during the charges year. This is because, to have complied through this prospective method means that the rebates and the charges offset each other over time. To explain this further, if between the charge and the later rebate, there is an increase in the value of the member's funds, for instance because of investment growth, the rebate will overcompensate for the charge and bring the charges lower. If however there is a dip in the value of the member's investments, the rebate will be correspondingly lower. An example of such a system might be a scheme which levies 1/365% on a daily basis, and then rebates one-twelfth of 0.25% at the end of each month.

121. Note that schemes which exhibit systematic bias against members, however small, will still not be able to comply by this method. An example would be a scheme which, as above, levies 1/365% on a daily basis, and then rebates one-twelfth of 0.25% at the end of each month, but does not apply a rebate for the final part-month's service when the member leaves mid-month. Such a scheme would not comply with the cap by the prospective method of assessment, because it would not meet the cap for any members who left mid-month.

122. Because the prospective method of assessment discounts fluctuations, contributions and withdrawals, it will not always be immediately clear that schemes which appear charge compliant do in fact comply for all possible members' joining and leaving dates through the charges year. Trustees should be careful to check a range of possible scenarios against regulation 8 before concluding that they are compliant.

123. It is not our intention to allow trustees and managers to switch between the different methods of charge cap assessment. If trustees are able to verify that their charges regime will meet the prospective test set out in regulation 8 then they may use that method to demonstrate compliance for any or all of the members invested in the default arrangement. If it later transpires that they are unable to use the charges regime which they have set out for the whole of the charges year, they will not comply with the requirement in regulation 8(2) and will need to fall back on assessing compliance for the full charges year for all members by using regulation 7. They may not use regulation 8 for the part year, or switch to an alternative charges regime.

**Example**

Fiona starts the year with £1000 of funds under management, and continues to contribute £100 per month. The charges year runs from 1January to 31-December, and quarterly reference points are set at 1 February, 1 May, 1 August and 1 November.

However using the prospective method of assessment, the actual funds under management in Fiona's pot are not used to confirm charge compliance. Instead it is assumed that she does not make any contributions or withdrawals and there is no fluctuation in the value of the members' investments.

Charges are levied at 1/365% of the fund's daily value each day of the month. On the final day of each month, the member is also given a rebate of (m/365) x 0.251%, where m is the number of days in the month. Because across the year a total of 1% is charged and a total of 0.251% is rebated, this arrangement could be referred to as having annual charges of 0.749%.

The value of Fiona's funds (ignoring fluctuations, contributions and withdrawals) at the 4 reference points would be £999.34, £997.51, £995.63 and £993.14. The small decline in funds under management over time is a result of the impact of charges.

The average of the reference point values above is £996.56, and the value at year end is £992.54. The total level of charges that would be imposed on this member, in this scenario would therefore be £7.46.

Expressed as a percentage, Fiona's charges are 0.749%, which is within the charge cap. The prospective method has therefore confirmed that the charge regime is compliant for a member who is invested at the start of the year, and remains invested for the rest of the year.

To comply with regulation 8, this charges regime would need to be compliant for all scheme members, irrespective of their starting dates and leaving dates from the scheme. If, for example, the charges regime did not pay a part-month rebate were Fiona to leave before the final day of the month (see para 120 above), this would result in the overall charge breaching the cap.

124. Respondents to the consultation made some final comments in answer to this consultation question. We consulted on a definition of the charges year as a year specified in any scheme document, or, if no such year is specified, a period of 12 months commencing on 6 April. In the absence of a year specified in a scheme document, this would enable trustees to ensure that they complied with the charge cap on the basis of a full year, rather than requiring them to pro-rate for a part year, as set out in regulation 2(3) and 2(4).

125. However, two respondents queried this approach.

"We also note that the Occupational Pension Scheme (Scheme Administration) Regulations defaults to the year commencing 1 April for a 'Scheme Year', so query whether a 6 April default is necessarily appropriate here."
**Association of Pension Lawyers**

126. We recognise that trustees may wish to align their scheme year for the purposes of the governance requirements with the charges year used for the charges measures. We have therefore amended the definition of the charges year in regulation 2 to provide that in the absence of a year set out in a scheme document, trustees can decide to set the charges year to commence on either 1st or 6th April.

127. Finally, three respondents queried the permitted charging models where trustees opt for daily assessment.

"We note there are issues with the use of reference points where units are priced daily. Daily pricing does not involve equal intervals given weekends and other days that the markets are closed and there would be a need to include the values on the days that a valuation is not done."
**Standard Life**

128. We do not believe that any amendment to the regulations is necessary to address the days when markets are closed. Schemes which intend to set daily reference points for valuing members' funds under management should therefore simply use the latest available value of funds under management on each day. Where a fund is not revalued over a weekend, for the purpose of calculating the average value of funds under management over the calendar year, the trustees should use each Friday's value for the Friday, and the also the subsequent Saturday, and Sunday.

**Example**

O&P Trustees use daily assessment to verify compliance with the charge cap. Their charges year runs from Wednesday 1 April to Thursday 31 March.

Jackie transfers a lump sum into the fund on Friday 25 March, and makes no further contributions in the remaining 6 days of that charges year. The default arrangement Q is valued on working days only.

The average of the reference point values is calculated as follows, where Value25-Mar, for example, is the value of Jackie's funds under management on 25 March, Value28-Mar is the value on 28 March and so on.

$$\frac{(3 \times \text{Value25-Mar}) + \text{Value28-Mar} + \text{Value29-Mar} + \text{Value30-Mar} + \text{Value31-Mar}}{7}$$

**We have not made any changes to the policy on the existing retrospective method of charge assessment. We have made some changes to the relevant regulation (regulation 7) purely for clarity.**

**We have created an alternative prospective method of charge assessment (regulation 8) by which a scheme may certify that its charging regime complies with the charge cap.**

**We have amended the definition of the charges year (regulation 2) so that where a year is not specified in a scheme document, trustees can decide to set the charges year to commence on either 1st or 6th April.**

## Opt-in services

**Consultation question:** Do you have any comments on the policy regarding opt-in services described above?

Do you have any comments on the draft regulation (regulation 9) which reflects that policy?

129. In our October 2013 consultation on charging, we asked about specific services that may need to be excluded from the cap to avoid constraining innovation. Responses to that consultation indicated that, while such services may be of value to some individuals, they are not suited to the automatic enrolment environment which relies on inertia, and should instead be offered on an opt-in basis as bespoke features of a member's fund. As a result, the March 2014 Command Paper announced that scheme members should not be defaulted into paying for services that might be seen as non-essential 'add ons', such as insurance products, bespoke advice and loyalty bonuses.

130. In our most recent Command Paper, published in October 2014 we refined this approach, proposing that we should not ban trustees and providers from offering such features by default where charges do not exceed the charge cap. We also provided that members may enter into a specific agreement to pay for additional, opt-in services of this nature and thereby incur charges above the level of the cap. This provided some additional safeguards by specifying that such agreements:

- should not be a condition of becoming or remaining a member of the scheme or arrangement;
- must include a statement that the charges may be higher than those permitted under the charge cap;
- could not be used for such services which the provider is already required under statute to provide;
- may not cover the core services provided by the scheme – which we defined as including: designing and implementing an investment strategy, investing contributions to the scheme, holding members' investments, and transferring into the default arrangement or out of the arrangement into a different arrangement, fund or scheme.

131. The majority of respondents to the consultation supported our proposed approach on opt-in services.

“We believe it is wholly appropriate to allow members to actively select opt-in services even if that leads to a higher cost. Providers will need to persuade members of the benefits of these additional services rather than relying on inertia and confusion but members should then have access to better services and the possibility of better outcomes.”
**Association of Consulting Actuaries**

132. Others were supportive of the general principle, but had concerns about the impact on existing members who were in receipt of services which resulted in the level of charges exceeding the cap. Some felt that there were capacity constraints in securing consent.

“We are concerned that the drafting of the regulation in relation to any agreement having to include statements could potentially disrupt existing agreements at the relevant date. We suggest that any agreement entered into before 6 April 2015 should not need to [include a statement that the charges may exceed the cap] before April 2016 at the earliest.”
**Capita**

133. Others felt that existing members should simply be given the option to opt out of such services where they exceeded the charge cap, rather than the proposed approach of requiring them to opt in.

“[The regulations] should allow for members who have these services or benefits to remain in their existing arrangement, but with the option of allowing members to make an active decision to opt out or discontinue these additional services and benefits.”
**Prudential**

134. Having reviewed the submitted responses, we are still of the view that, in most cases, the appropriate action is for trustees to seek active member agreement to receive any additional services which result in the level of charges exceeding the cap. Many of these services appear to have been offered as standard for many years and members may not have used them or have been recently asked whether they wish to continue to be charged to receive them. Given that automatic enrolment relies on member inertia, it is not appropriate to use inertia to default members into paying for such non-essential services, which they may not value or use.

135. If trustees do not wish to communicate with members to secure their agreement, they may also take steps to reduce the cost of the services, for instance by reducing the frequency with which services such as investment advice are offered, to bring them within the default fund charge cap. They may also choose to withdraw these services from members, as an alternative to offering them on an opt-in basis.

## Death benefits

136. We have decided to make an exception for death benefits (i.e. life cover or death in service cover). Here a process of requiring members to opt in may not be appropriate because these are currently offered within schemes on a ‘pooled risk’ basis and underwritten as a bulk policy. Where members actively opted to take up these services they would be considered ‘self-selectors’, and their death benefits would need to be individually underwritten, which would be likely to result in more costly cover.

"[Organisation-wide] death in service ... delivers better rates than an individual may have been able to obtain. The provider assesses risk across the employer's workforce and this means individual underwriting within the agreed levels of cover is not required. This benefits the members who may otherwise be considered are 'poorer risks."

**Standard Life**

137. We have therefore decided that those costs which are solely associated with the provision of death benefits should be excluded from the definition of charges subject to the cap in regulation 2. No member agreement will therefore be needed to provide these benefits, as charges associated with their provision will not count towards the level considered for the purposes of the cap.

## Written agreement

138. Most respondents agreed that there were sufficient safeguards in place around the written agreement required for members to incur charges above the level of the cap, to ensure that they were adequately protected from signing up inappropriately to services.

139. A few respondents queried details of the written agreement.

"It is not clear whether this written agreement can be included within the terms and conditions issued to the member as part of the automatic enrolment process. If so we would expect the provider to clearly state which options and services are not included within the charge cap."

**Hargreaves Lansdown**

140. The blank agreement may be provided alongside the terms and conditions which are issued to the member during automatic enrolment, but as set out in regulation 9(2)(a), member agreement must be in writing. Therefore agreement to pay for the services must be an active agreement rather than simply not opting out. As long as this has taken place, there is no requirement for the member to enter into a new agreement when they first use the service, or each time they use the service. Agreement in writing is explained in regulation 2 to include agreement via electronic communication.[12]

141. Another respondent queried the parties to any member agreement.

"In the case of a wholly insured scheme, for example, where the policy contract is with the trustees and not the member, does DWP envisage that a tripartite agreement would be entered into between the trustees, provider and the member regarding additional services paid for from the policy?"

**Aegon**

142. We have not set any legal requirements around the parties to the agreement, but in occupational schemes, regardless of who provided the opt-in service, the trustees, who bear the responsibility of compliance with the charge cap, would need to satisfy themselves that the legal requirements for member agreement for services had been met.

## Core services

143. Several respondents queried the definition of core services, specified in regulation 9(4), and whether it may be too wide.

[12] Electronic communication' is defined by section 15 of the Electronic Communications Act 2000.

"The definition of "core service" is so wide (in particular, it includes anything to do with the "investment of contributions to the scheme"), that it is difficult to see any practical example of when a member could actually fall within this section."

**Wragge, Lawrence Graham and Co LLP**

144. We recognise that not setting out an exhaustive list of core services in the regulations may require trustees to consider, on a case-by-case basis, whether a particular service should be offered within the cap as part of the default offering. We do not consider this an undesirable outcome as trustees will wish to take into account scheme-specific factors, such as the membership size, in designing the offering. Furthermore, to devise an exhaustive list could risk omitting services which are currently being offered as standard in many schemes, with the possible result that the scheme does not continue to provide this service within the cap.

145. Three respondents were unclear about the description of designing and implementing an investment strategy as a core service.

"[This] seems to forbid a specific service that the member might actually wish to purchase – that is, a specific investment strategy for their own needs."

**Aviva**

146. To be clear, this regulation relates to permitting charges levied on members of the default arrangement to exceed the charge cap where they opt in to additional services. It does not limit the opportunity for trustees to charge in excess of the cap for non-default funds and arrangements (those which do not meet the definition of a default in regulation 3), or their design, as these are out of scope of the default fund charge cap altogether.

**We have modified the definition of charges in regulation 2 so that those costs which are solely associated with the provision of death benefits should be excluded from the definition of charges subject to the cap. No member agreement on costs will therefore be needed before providing these benefits.**

**We have not changed the policy or the regulations on opt-in services as set out in regulation 9.**

## Transfers and decumulation

147. In the October Command Paper, we explained that administrative charges associated with transfers into or out of the default arrangement of a workplace scheme would be subject to the charge cap.

148. We did not specifically consult on this point, as it had already been announced in March 2014, and only a couple of consultation responses raised the question of transfers.

"We think that charges for automatic transfers should be excluded from the cap as the costs are likely to be material, especially as many of the transfers will need to be processed manually by the receiving scheme."

**Mercer**

149. We are working with the pensions industry to design the automatic transfers implementation system. One of the objectives of the system is to make automatic transfers as efficient as possible. The new system will require far less manual intervention than member-initiated transfers, leading to reduced transfer costs. We will publish a separate document setting out

detail of the automatic transfers system shortly, and will consult on regulations to implement this system later this year. It remains our policy intention that both member-initiated and automatic transfers will take place within the cap.

150. A number of other respondents raised questions about the application of the charge cap in the light of the new pension flexibilities announced in the 2014 Budget.

151. As we announced in the October Command Paper, our intention is that the charge cap will continue to apply for as long as the member's funds remain invested in the default arrangement. This would include, for instance, a situation where trustees or providers and the member have agreed that the member may access their pension savings whilst invested in the default. In this situation, however, trustees may require that the member enters into a written agreement to pay for this access, in line with other opt-in services (although to note that some scheme rules may give members a right to this flexibility already, in which case the trustees may not be able to levy an additional charge). This could take the form of a flat fee, a percentage charge on the funds withdrawn, or a percentage charge of the funds under management, or a combination of these.

152. Alternatively, trustees may require that the member transfers some or all of their funds to an alternative drawdown arrangement from which they could then gain access to the new pension flexibilities. The transfer out would constitute a core service under regulation 9(4), and would therefore be subject to the cap. However, the costs of transferring into the drawdown arrangement and the ongoing charges of remaining in the drawdown arrangement would not themselves be capped, provided that arrangement is not itself a default arrangement subject to the cap.

153. Most respondents agreed with this approach.

"With effect from April 2015, a scheme could create individual flexibility for a member to transfer to alternative arrangements or funds as frequently as the member wishes. We believe that schemes should be permitted to reserve the right to charge members for this increased flexibility where they take up the option."
**Now: Pensions**

154. In contrast, a couple of respondents differed on this point, suggesting that the Government should cap charges for accessing the new flexibilities.

"Even with the additional flexibilities, many consumers will select the default option for accessing their pension from their existing scheme. It is essential that consumers accessing income drawdown are protected from excessive charges. The Government should expand the charge cap so that it applies to consumers remaining in the default investment option and accessing their fund through income drawdown."
**Dominic Lindley**

155. On further consideration, the Government considers that the position outlined in the October Command Paper and draft regulations, that flexible access to savings pre-retirement should not constitute a core service for which additional charges above the cap cannot apply, is still appropriate. We recognise the need to ensure that consumers accessing the new flexibilities receive a fair deal but the products currently available in the market are focussed on particular consumers with large funds and specific requirements, with correspondingly higher costs. With the introduction of the pension flexibilities, products will move into the mass-market, and we expect this to exert downward pressure on costs. Whilst this market is changing rapidly, we would have little evidence on which to draw when setting an appropriate level of any cap on decumulation costs. Any proposed cap could therefore have unintended consequences.

156. However, Government and regulators are monitoring the development of new retirement income products, including the next generation of drawdown products. In the publication of provisional findings from its Retirement Income Market study, the FCA committed to closely monitor how the retirement income market develops and to take action where appropriate if it sees sources of consumer detriment arising or if competition is not working properly in the market. In addition, the FCA has committed to undertake a full review of its rules in relation to the retirement income market, commencing in the first half of 2015.

157. Government and regulators will therefore continue to monitor both the level of costs associated with these options and the interaction with the default fund charge cap to ensure that consumers are protected . We already have powers to cap charges in all pension schemes, including drawdown products for instance, and will take action, if necessary.

**We have not made any amendments to the policy or regulations on transfers and decumulation.**

## Active Member Discounts

**Consultation question:** Do you have any comments on the policy in relation to Active Member Discounts?

Do you have any comments on the draft regulation which reflects this policy?

158. The Government announced in its March 2014 Command Paper that Active Member Discounts (AMDs) would be banned in qualifying schemes from April 2016 (or the employer's staging date if later). We also said that any AMD structures in place in qualifying schemes between April 2015 and April 2016 would be subject to the charge cap, such that they could not levy a charge that exceeded the level of the charge cap on members who ceased contributing during this period.

159. The October Command Paper set out our proposed approach for implementing the ban. We proposed that the AMD ban would apply to those members who make a contribution to a qualifying scheme[13] on or after 6 April 2016 whilst working for their employer. We also designed the ban so that a non-contributing member should not have to pay more than they would if they were a contributing member with the same number of years' contributions, value of funds under management and making the same level of contribution as at their last contribution. This was intended to ensure a fully effective ban on AMDs without inadvertently prohibiting other types of charge structure, such as tiered charging structures, where member charges fall with increasing years of contributions, or funds under management.

160. Nearly all respondents agreed with our proposed approach. A couple of respondents were concerned that the ban would only apply to members who made a contribution whilst working for their employer after the date these regulations come into force. As with the application of the cap, we considered here the principle of protecting members alongside the need to minimise the disruption to schemes and providers, as well as the information which will be available to trustees and providers about scheme members. Most respondents agreed that this struck an appropriate balance.

[13] In the context of the AMD ban, a qualifying scheme means any scheme which is a qualifying scheme in relation to one or more jobholders of an employer, at any date on or after 6 April 2016 – see regulation 11(5).

"We agree that members who leave their employers from April 2016 should not have to pay higher charges for their pension. We support the application of the charge cap to the charges of members who have ceased contributing to a qualifying scheme from April 2015 and the ban on active member discount from 2016."
**Association of British Insurers**

161. Some respondents queried whether, as drafted, the ban would only apply to those charging structures that will be subject to the charge cap.

"In [this] regulation ... should the prohibition relate simply to charges and rates over 'the single charge structure' or 'a combination structure', given that these are the definitions used?"
**Wragge Lawrence Graham & Co LLP**

162. On further consideration, we agree that the regulations as drafted did appear to limit the ban to single or dual charge structures. We have therefore amended the regulations so that they are no longer limited to these charging structures.

163. We also proposed that employers would not be banned from paying some or all of the charges on behalf of their current employees, as long as the overall charge level imposed on the member's funds was the same irrespective of whether the member was contributing or not contributing. This was broadly welcomed.

"Although it may be argued that allowing employers to pay (some of) the charges for employees but not former employees has the same impact as an Active Member Discount (AMD), we endorse the policy. Employers will be more likely to negotiate the best possible terms if they are explicitly bearing the costs and deferred members will benefit from this alongside active members."
**Association of Consulting Actuaries**

164. A few respondents were unclear whether the regulations achieve this intent because members who leave the employer may face higher charges since they would not benefit from the employer's subsidy.

"We fully support the policy both in terms of the ban on AMDs and of allowing employers to pay some of the charges for active members if they wish to do so. However, we do not think that [the] regulation .. makes this possibility for employers entirely clear"
**Mercer**

165. We made clear in the October Command Paper that the AMD ban would not prevent this employer practice. Regulation 11(1) describes trustees and managers imposing higher charges "on a non-contributing member" – this means the overall level of charges to which the member's funds are subject (regardless of who pays), not the charges borne by the member themself. The key point here is that the employer may subsidise active members, but the latter should not be subsidised by deferred members. This means that the amount the employer pays must be equal to the subsidy the employees receive. For example, in a combination charge structure where the charges are 0.4% of funds under management and a flat fee of £15 per annum for all scheme members, the employer could choose to pay the £15 flat fee on behalf of their current employees.

166. A few respondents were unclear on whether the AMD ban would also ban tiered charging structures.

"We would presume any reduction in charges which occurs as a result of continuing contributions leading to a larger fund would be permissible?"
**Aviva**

167. As explained above at paragraph 159, the AMD ban has been designed specifically so that it does not have this impact and schemes that reward members with lower charges based on a level or period of contributions or a level of funds under management are permitted as long as they meet the comparison outlined in regulation 11(2).

168. One respondent also queried whether opt-in services which bear an additional charge, such as a decumulation product, might also be caught by the AMD ban.

169. We proposed in the October Command Paper that such opt-in services which members have actively signed up to in line with regulation 9 will not be subject to either the charge cap or AMD ban. This is covered by regulation 9(1) which sets out that restrictions in regulation 4 (dealing with restrictions on charges) do not apply in respect of opt-in services – specifically regulation 4(1)(b) which concerns the AMD ban. Respondents agreed with our approach.

"The policy on opt-in services seems a fair balance between protection of the member and allowing freedoms if desired."
**Buck Consultants**

**We have modified regulation 11 to ensure that the ban on Active Member Discounts is not limited to those charging structures subject to the default fund charge cap.**

**We have not made any other changes to the provisions on AMDs.**

## Summary of changes

**We have not made any changes to the policy on who should have the duty of compliance with the charges measures.**

**Trustees and managers will have this duty in occupational pension schemes.**

**We have not amended the definition of transaction costs. We have improved the clarity of some items in the list of examples of costs and charges which we would expect to be included in and excluded from the cap, but these do not form part of the regulations.**

**We have not made any amendment to the existing exclusions of earmarking, pension sharing cases and winding up costs.**

**We have amended the definition of contributing members (regulation 2) to make clear that only members who are accruing money purchase benefits should be considered.**

**We have also changed the definition of contributing member for the purposes of regulation 3, so that a member whose only contributions to money purchase benefits are AVCs are excluded from the 80% test.**

**We have amended the text of the regulation relating to ongoing monitoring of the 80% test (regulation 3(2)(c)). We have not changed the policy.**

**We have removed the maximum time limit ahead of the relevant date in which the opt-in regulation 3(3) applies.**

**We have not made any changes to the policy concerning to whom the cap applies.**

**We have amended the regulations to clarify that the cap applies from the date that the first contribution is received, including contributions received on the relevant date.**

**We have not made any amendments to the policy on the funds to which the cap applies – where the cap applies to a default arrangement, it will apply to the total fund of the member invested in that arrangement.**

**We have not made any amendments to the proposed policy on permissible charge structures. Only single or dual charge structures will be permitted.**

**We have not made any amendments to the proposed policy on changing charge structures. Changes in charge structure will only be permitted at the end of a charges year.**

**We have not made any changes to the policy on the existing retrospective method of charge assessment. We have made some changes to the relevant regulation (regulation 7) for clarity.**

**We have created an alternative prospective method of charge assessment (regulation 8) by which a scheme may certify that its charging regime complies with the charge cap.**

**We have amended the definition of the charges year (regulation 2) so that where a year is not specified in a scheme document, trustees can decide to set the charges year to commence on either 1st or 6th April.**

**We have modified the definition of charges in regulation 2 so that those costs which are solely associated with the provision of death benefits should be excluded from the definition of charges subject to the cap. No member agreement on costs will therefore be needed before providing these benefits.**

**We have not changed the policy or the regulations on opt-in services as set out in regulation 9.**

**We have not made any amendments to the policy or regulations on transfers and decumulation.**

**We have modified regulation 11 to ensure that the ban on Active Member Discounts is not limited to those charging structures subject to the default fund charge cap.**

**We have not made any other changes to the provisions on AMDs.**

# Compliance 4

## Introduction

1. The October Command Paper outlined our proposed regulatory and compliance approach for occupational schemes, which is designed to ensure that schemes offering money purchase benefits meet minimum governance standards and protect members from high and unfair charges. The Command Paper consulted on our policy proposals and the draft regulations that would implement these policies. The policies and regulations only apply to occupational pension schemes, which are regulated by The Pensions Regulator (TPR). The Financial Conduct Authority (FCA) will be introducing equivalent rules for workplace personal pension schemes. This chapter sets out the Government's response to this consultation.

## Reporting compliance to TPR

**Consultation question:** Is the scheme return the most proportionate way to obtain information on compliance with the governance standards and charges measures? Draft regulation 24 sets this out in more detail.

2. Most respondents to this question agreed that the scheme return was a proportionate way to obtain information on scheme compliance with the governance standards and charges measures.

3. Where respondents gave more detail, one suggested that the method of using scheme returns as a source of information on compliance should be subject to a review process. Another suggested that the FCA should use a similar mechanism for confirming compliance in workplace personal pension schemes. One respondent noted that the information received from the scheme return could be quite narrow as it was limited to a yes or no statement about whether the scheme had complied.

4. Having considered these responses we feel that the scheme return remains the most appropriate and proportionate way to gather information on compliance with the governance standards and charges measures. We will however keep this under review, working with the FCA to hold a combined review of Independent Governance Committees (IGCs) and workplace pension governance and charges reforms.

**Consultation question:** Is the proposed compliance approach to the Chair's Statement, as described in draft regulations appropriate and proportionate?

5. Most respondents agreed that the compliance approach to the Chair's Statement was appropriate and proportionate.

6. One respondent said that they would like the regulations to say that trustees would recompense members for any maladministration. We have considered this point; however, scheme members already have the right to apply to the Pensions Ombudsman if they believe they should be compensated for overcharging or maladministration. We therefore do not think this provision needs to be set out in regulations.

7. Several respondees commented on the provision to make it mandatory for TPR to issue compliance or penalty notices, mentioning that this would be inconsistent with TPR's usual role. We agree that it is sensible to change the regulations to reflect this and have therefore changed regulations 26, 27 and 28 to reflect this point. However, we continue to believe that where the trustees and managers have failed to produce a Chair's Statement, there should be an automatic penalty. Therefore we have inserted regulation 28(2) to provide TPR with the power to do this.

8. A number of respondents pointed out that, as drafted, the regulations made double provision of compliance measures against the new regulations 2A and 4A of the Investment Regulations[14]. TPR would be able to use improvement or third party notices, as provided for under sections 13(1) and 14(1) of the Pensions Act 2004, and also the separate financial penalty under sections 35(6) and 36(8) of the Pensions Act 1995; but would also be able to use the compliance measures provided directly by these regulations. We agree that this would be a confusing situation and could lead to schemes being treated differently for the same breach. Therefore we have redrafted the regulations so that enforcement of new regulations 2A and 4A of the Investment Regulations remains wholly under the 2004 and 1995 Acts.

9. We are also of the view that it would be inappropriate for the new governance provisions under these regulations to be enforced under different secondary legislation than the existing governance provisions in the current Administration Regulations[15] and Investment Regulations. In order to keep the enforcement regime consistent across the Administration Regulations and Investment Regulations as a whole, as amended by these regulations, we have therefore changed the regulations so that compliance measures for all the new governance standards sit under sections 13 and 14 of the 2004 Pensions Act. The exception to this is a free-standing financial penalty under regulation 28(1)(b)(iii) in relation to new Part V of the Administration Regulations. This new free-standing financial penalty is necessary because otherwise there would be no such free-standing penalty available for that new Part V.

14 The Occupational Pension Schemes (Investment) Regulations 2005.
15 The Occupational Pension Schemes (Scheme Administration ) Regulation 1996.

10. Some respondents mentioned that under the draft regulations any penalty notice must be issued to all trustees on a joint and several basis, however, there is no equivalent for compliance notices. They suggested that compliance notices should also be issued to all trustees.

11. We have carefully considered this point; however we have decided not to make a change to the regulations. The words at regulation 28(5)(a) and (b) are intended to make it clear that liability for a financial penalty must be shared between all individual persons to whom it is issued, so that the financial burden is not borne unequally between trustees or managers. In contrast, regulation 26 is designed to ensure that the trustees or managers as a whole, acting as a single body, carry out the steps required by a compliance notice. Since the liability of individual trustees or managers is not the focus of regulation 26 (rather, the focus is the action of the trustees or managers as a whole), we do not consider that the compliance notice provided for in regulation 26 needs to be issued on a joint and several liability basis.

12. In addition, one response mentioned that we needed to add additional provision to cover the issuing of penalty notices to officers of a body corporate on a joint and several liability basis. We have added new regulations 28(5)(b) and (c), giving TPR the powers to carry out that function.

## Charge limit adjustment

**Consultation questions:** Do the adjustment regulations reflect our policy intent of providing an adjustment mechanism for occupational schemes which cannot stay compliant with the charge cap to take action to resolve the situation promptly?

Do the adjustment regulations meet the policy intention of providing an adjustment mechanism for occupational schemes when, as a result of an unexpected event, they are unlikely to be able to comply with the cap?

13. The October Command Paper made clear that we expect trustees to be compliant with the charge cap when it is introduced on 6 April 2015. Where trustees know before 6 April 2015 that this will not be the case, they should close the arrangement to future contributions and divert these future contributions to a charge compliant default arrangement. Where trustees decide to allow it, members can still make an active choice to continue contributing to the 'old' default arrangement.

14. However, there may be circumstances where trustees initially think their scheme will be compliant with the cap but then determine after the cap is introduced that this is not the case. We therefore proposed that trustees would have the option to invoke an 'adjustment measure' in two specific circumstances.

15. The first is where trustees initially think their scheme is compliant but then identify a short time after the introduction of the cap that it is unlikely to be compliant for the whole of that charges year or the following charges year, despite their best endeavours. Under this measure, which will only be available between 6 April and 5 October 2015, trustees will still be required to be compliant with the cap but they could start the process of closing the arrangement to future contributions and diverting them to a compliant arrangement. The original arrangement would not be subject to the cap from the point that the trustees make the adjustment and close the arrangement to future contributions.

16. The second applies where an unexpected event results in an increase in costs that makes it difficult for trustees to remain compliant with the cap despite their best endeavours. Due to the unforeseen nature of these events there is no time limit for accessing this measure but once trustees decide they are unlikely to remain compliant they will only have a six month period to carry out the process described in the first option above. We expect that this option will only be used in the most exceptional circumstances and will monitor its use to ensure it is not used improperly.

17. If trustees decide to offer workers the option to continue contributing to that fund, then any worker agreement must be provided in writing and must come with an acknowledgement that they may be subject to charges higher than those allowed under the charge cap.

18. To allow trustees to proceed quickly to close arrangements to future contributions when they can no longer comply with the cap, we have, in regulation 13, given trustees the unilateral power to change schemes for the purposes of implementing an adjustment measure, and to exclude implementation of the adjustment measure from the circumstances in which the employer has a duty to consult. Many respondents agreed with our proposed approach.

"We see the approach in [the] draft regulation ... as acceptable although it needs to be made clear to trustees that this provision should be the exception rather than the rule."
**Aon Hewitt**

19. A few respondents thought that we should clarify in guidance what was meant by 'best endeavours'. However, the legal meaning of the phrase 'best endeavours' has been considered by the courts and we therefore do not think further elaboration is necessary in guidance.

20. Some respondents thought there was no need for the adjustment measure and that all schemes used as qualifying schemes for automatic enrolment should be compliant with the cap. Others thought that it was inequitable to make this available to occupational pension schemes and not to workplace personal pension schemes.

"There are provisions available to all schemes to close the default arrangement where it cannot comply with the charge cap and to enrol members into a new default arrangement (providing them with the opportunity to remain invested in their current fund). These provisions should be sufficient for all schemes and as such we do not believe that providing the additional adjustment mechanism for occupational schemes is necessary, or equitable to the providers of contract-based schemes."
**Association of British Insurers**

21. Having considered all of the responses we still believe it is appropriate that the adjustment measure should be available to trustees. The October Command Paper highlighted differences in scheme funding between occupational and workplace personal pension schemes. In particular, it identified that insurers, who are normally providers of workplace personal pension schemes, have financial reserves that are not usually available to occupational schemes.

22. In contrast, occupational defined contribution schemes operate within a closed loop of funding which means that they do not have access to funds beyond, in the main, contributions from their members or the employer. One respondent agreed with this point.

> "Taking on board the constraints around the ability of trustees to fund compensation for higher than charge cap charges (they may not have access to funds to pay compensation) we feel that the proposals are proportionate where the trustees have taken all appropriate steps to comply. Where the trustees have not taken the steps required to comply we would presume that The Pensions Regulator would take an interest and use their compliance powers."
>
> **Friends Life**

24. Once trustees decide to invoke the adjustment measure, they will be required to give TPR one month's notice of the 'adjustment date', which is the date the measure will come into effect. TPR has the power to take action against trustees who do not comply with the requirements set out in regulation 10 when attempting to use this measure.

25. Following discussions with TPR we have made a few technical drafting changes to make the regulations about compliance clearer.

## Chapter summary

**We have changed the regulations so that TPR are not mandatorily required to issue compliance or penalty notices except where a Chair's Statement has not been completed in which case an automatic penalty applies.**

**We have amended the regulations so that enforcement of new regulations 2A and 4A of the Investment Regulations remains wholly under the 2004 Pensions Act.**

**We have changed the regulations so that compliance measures for all the new governance standards sit under sections 13 and 14 of the 2004 Pensions Act. The exception to this is where we have inserted a free-standing financial penalty under regulation 28(1)(b)(iii) in relation to new Part V of the Administration Regulations.**

**We have added new regulations 28(5)(b) and (c), giving TPR the powers to issue penalty notices to officers of a body corporate on a joint and several liability basis.**

**We have not made any changes to the policy on the adjustment measure.**

# Annex A
# Non-exhaustive list of costs and charges

| In scope of the default fund charge cap on Member-Borne Deductions (MBDs): all MBDs relating to scheme and investment administration paid to the pension provider or another third party |
|---|
| Set-up fees |
| Scheme-level entry fees; both on entry into, or on transferring a pre-existing pot into, the scheme |
| Scheme-level exit charges |
| Fees (excluding transaction costs) for non member-initiated switching of funds |
| Fees paid to governance bodies, e.g. trustees, IGCs and others |
| Governance charges and expenses, e.g. trustee insurance |
| Fund or investment management fee, payments to investment consultants and administrators, including underlying and separate in-house fund managers, performance fees etc |
| Ongoing charges for underlying funds in investment portfolio, e.g. fee for holding units in a UCITS fund |
| Ongoing costs for running of scheme, e.g. IT, office and staffing costs, data management and record keeping |
| Registration and regulatory costs and fees |
| Payments to providers of professional services and other third parties or fees for related services, e.g. administrators, advisers, actuaries, lawyers, auditors, audit and legal fees for investment, accounting fees, valuation services |
| Depositary fees and fees to the custody bank (excluding transaction costs) |
| Banking fees |
| Costs of member communication services, e.g. statement costs, website, printing/ posting accounts |
| Costs of capital requirements |
| Unrecoverable VAT |
| Payments to shareholder service providers |
| Platform fees |
| Commission (pending ban from April 2016) |

| **Excluded from the default fund charge cap on MBDs: transaction costs – the costs incurred as a result of buying, selling, lending and borrowing of investments** |
|---|
| Dealing commission and fees, including payments for other goods and services provided in return, e.g. research[16] |
| Transaction taxes, e.g. stamp duty and non-reclaimable withholding taxes on dividends |
| Spreads, e.g. bid-offer on bonds, foreign exchange (and associated costs such as commission) |
| Other charges embedded in the transaction price, e.g. payments incurred through financial derivative instruments |
| Custodian transaction costs (‘ticket fees’) |
| Deductions of expenses or fees from income earned by other transactions relating to the underlying assets – e.g. stock lending, foreign currency exchange. |

16 This item has replaced brokerage commission and fees and soft commission services – this change has been made purely to align with the terminology in FCA’s Conduct of Business Sourcebook (CoBS) and no change in coverage is intended.

# Annex B Glosssary

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| **Active member** | A member of a pension scheme who is at present accruing benefits under that scheme. |
| **Active member discount (AMD)** | A charge structure whereby active members of a scheme are charged a lower amount than they would be if they were not contributing. |
| **Additional Voluntary Contributions (AVC)** | An extra pension contribution which a member may choose to make to increase their retirement income, often within a final or average salary scheme. |
| **Administration** | The day to day running of a pension scheme. This may include collecting contributions and payment of benefits. |
| **Adviser** | A professional who renders financial services to clients. |
| **Annual management charge (AMC)** | An annual charge levied on the value of the scheme fund. It may cover a combination of the sales, administration and fund management costs of the fund. |
| **Annuity** | The fixed sum of money paid to individuals each year upon retirement. This is typically for the rest of their life based on their total accumulated pension savings. |
| **Automatic enrolment** | Employers are be required to make arrangements by which eligible jobholders become active members of an automatic enrolment scheme with effect from the automatic enrolment date. Automatic enrolment is not applicable if the jobholder is an active member of a qualifying scheme on that date. |

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| **Automatic transfer** | Ensuring that the previous small pots of individuals are automatically matched when they move jobs and that they have the opportunity to consolidate their pots. This will be done through member consent initially, although ultimately the transfer will take place unless the individual opts out. |
| **Bundled schemes** | Pension schemes where the pension provider also administers the scheme. |
| **Commission** | A payment, which may be either an upfront or on-going fee (often called trail commission) or both, for advice services agreed between a scheme provider and an adviser. The cost is recouped through member-borne charges. |
| **Consultancy charging** | An upfront fee for advice services agreed between an employer and an adviser. The cost is recouped through member-borne charges. |
| **Contract-based schemes** | Schemes where a pension provider, often an insurance company, runs the scheme. The scheme members will sign a contract with the provider who will make the majority of decisions about the way the scheme is run. |
| **Contributions** | The money paid by members and employers to the pension scheme. |
| **Decumulation** | The process of converting pension savings into a retirement income. |
| **Default arrangement** | This generally means the investment vehicles that are selected automatically for a member joining a pension scheme, unless that member selects an alternative investment strategy. |
| **Defined Benefit (DB)** | A scheme in which the benefits are defined in the scheme rules and accrue independently of the contributions payable and investment returns. |
| **Defined Contribution (DC)** | A defined contribution scheme's benefits are based on how much the member and employer pay into the scheme, and also on the performance of the investments made with that money. The Pension Schemes Bill defines a Defined Contribution Scheme as one in which there are no promises in relation to any of the benefits during the accumulation phase. |
| **Financial Conduct Authority (FCA)** | The FCA is responsible for regulating the standards of conduct in retail and wholesale, financial markets and for supervising the infrastructure that supports those markets. |
| **Group personal pension (GPP)** | A pension scheme which is organised through the employer, but still takes the form of individual contracts between the employee and the pension provider. |
| **Hybrid scheme** | A hybrid scheme is a mixture of defined benefit (DB) and defined contribution (DC). |
| **Independent Financial Adviser (IFA)** | Someone who is authorised to provide advice and sell a wide range of financial products. |

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| **Investment Manager** | An individual (or company) to whom the management of all or part of a scheme's assets is delegated. |
| **Investment Strategy** | The rules and procedures for the selection of the range of investment products for a pension scheme. |
| **Master trust** | A multi-employer pension scheme where each employer has its own division within the master arrangement. There is one legal trust and, therefore, one trustee board. |
| **Member** | An individual who has contributed and/or continues to contribute. |
| **Member-borne deductions** | All deductions paid by members of pension schemes to the pension provider or another third party. |
| **Money purchase benefits** | Where the rate or amount of the benefit is based on the contributions made by or on behalf of the member and investment returns, less charges. The benefit is calculated solely by reference to assets which must necessarily suffice for the purposes of its provision to or in respect of the member – i.e. there is no promise which can give rise to a deficit in the scheme. |
| **Money purchase scheme** | Pension scheme where all the benefits are money purchase benefits. |
| **NEST** | A defined contribution occupational pension scheme backed by the government. It has a public service obligation to let any employer that wishes to use it to do so, regardless of their size. |
| **Non-contributing members** | In defined contribution schemes, this is someone who no longer contributes to the scheme but is not yet a beneficiary of that scheme. In some contract-based arrangements the member may be reclassified as a member of an Individual Personal Pension rather than a Group Personal Pension. |
| **Occupational pension** | A pension which is provided via a person's employment, normally taking the form of a trust arrangement. |
| **Pension scheme** | The arrangement by which an employer and, usually, an employee pay into a fund that is invested to provide the employee with a retirement benefit in the form of an income or a cash amount, depending on the scheme design. |
| **Retail Distribution Review (RDR)** | On 1 January 2013, the RDR introduced new rules from the then FSA on how financial advisory companies could operate. These rules included a stipulation that advisers are not able to take commission as a form of remuneration but instead will have to quote a fee for any advice given. |
| **Stakeholder pension** | Type of pension scheme introduced in 2001, required to meet a number of conditions set out in legislation, including a cap on charges, low minimum contributions, and flexibility in relation to stopping and starting contributions. |
| **The Pensions Regulator (TPR)** | TPR regulates occupational pension schemes in the UK. |

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| **Total Expense Ratio** | Another measure of scheme or fund charges, broader than the Annual Management Charge (AMC). |
| **Transaction costs** | Variable trading costs that a scheme incurs as a result of buying, selling, lending and borrowing investments. These costs cannot be predicted at the beginning of a reporting period as they are dependent on the level and nature of trading undertaken by a scheme, which in turn is influenced by market conditions. |
| **Trustees** | A member of the board of trustees responsible for the management, administration and investment of the pension assets. |
| **Trust based schemes** | A scheme that is managed by a board of trustees. The trustees have full responsibility for the management, administration and investment of the plan. The trustees' fiduciary duty is to run the scheme according to the trust deed and rules which may have been setup by, for example, the employer – and to act in the interests of members and while they can delegate tasks to various specialists, such as investment managers, the responsibility remains with the trustee. |
| **Unbundled schemes** | A pension scheme where there is separation in the provider of either the investment management or administration of a scheme. |
| **Workplace pensions** | A pension provided by an employer. |

# Annex C
# List of respondents

The 100 Group Pensions Committee
Addleshaw Goddard LLP
Aegon
Akzo Nobel UK Ltd
Aon Hewitt
Aquila Heywood
Ashurst LLP
Association of British Insurers
Association of Consulting Actuaries
Association of Pension Lawyers
Aviva
Barclays Pension Funds Trustees Limited
Buck Consultants
Capita
Charlton Frank
Dalriada
Dominic Lindley
EEF
Elston Consulting
Eversheds LLP
Friends Life
Hargreaves Lansdown
Hymans Robertson
ICAEW
Investment Association
Institute and Faculty of Actuaries
Law Society of Scotland
Mercer
MNOPF Trustees Ltd
National Association of Pension Funds
National Employment Savings Trust
Now: Pensions
Prudential
PTL
Railways Pension Trustee Company Limited
Royal London
Sacker and Partners LLP
Scottish Widows
ShareAction
Slaughter and May
Society of Pension Professionals
Squire Patton Boggs (UK) LLP
St. James's Place
Standard Life
The People's Pension
TISA
Towers Watson
Travers Smith
Trades Union Congress
Which?
Wragge Lawrence Graham & Co LLP
Zurich

This publication can be accessed online at:
**https://www.gov.uk/government/consultations/better-workplace-pensions-putting-savers-interests-first**

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