Department for Work & Pensions

Research Summary

GOVERNMENT SOCIAL RESEARCH
Social Science in Government

Pension Charges Survey 2016

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Background

In March 2014, the Department for Work and Pensions (DWP) published a Command Paper, which announced a comprehensive range of charges measures designed to improve the value for money of defined contribution (DC) workplace schemes, including a charge cap of 0.75 per cent on default arrangements.

In conjunction with the new charges measures, DWP commissioned the first wave of the Pension Charges Survey in 2015, and subsequently this second wave in 2016. Both were designed to capture the full range of charges that were applied to DC workplace pension schemes.

Methods

The 2015 survey focused on the year leading up to April 2015 when the charge cap was introduced. This report, covering the 2016 survey, provides comparable data covering the period after the introduction of the charges measures.

It focuses on charges incurred by members whose investments are not in drawdown products, and incorporates the full range of DC schemes. We asked pension providers to collect charges data using an Excel template designed by our research team, and to participate in a follow-up interview. In total, 14 pension providers participated, including eight of the top ten providers by market share.

In 2016 for the first time, we also conducted a programme of telephone and face-to-face interviews with 112 qualifying and 125 non-qualifying unbundled schemes. These are schemes where trustees, often based at a single employer, work directly with separate administrators and investment managers to administer the scheme. In total the research covers 15.1 million pension pots.

Key findings

Summary of member-borne charges within the cap

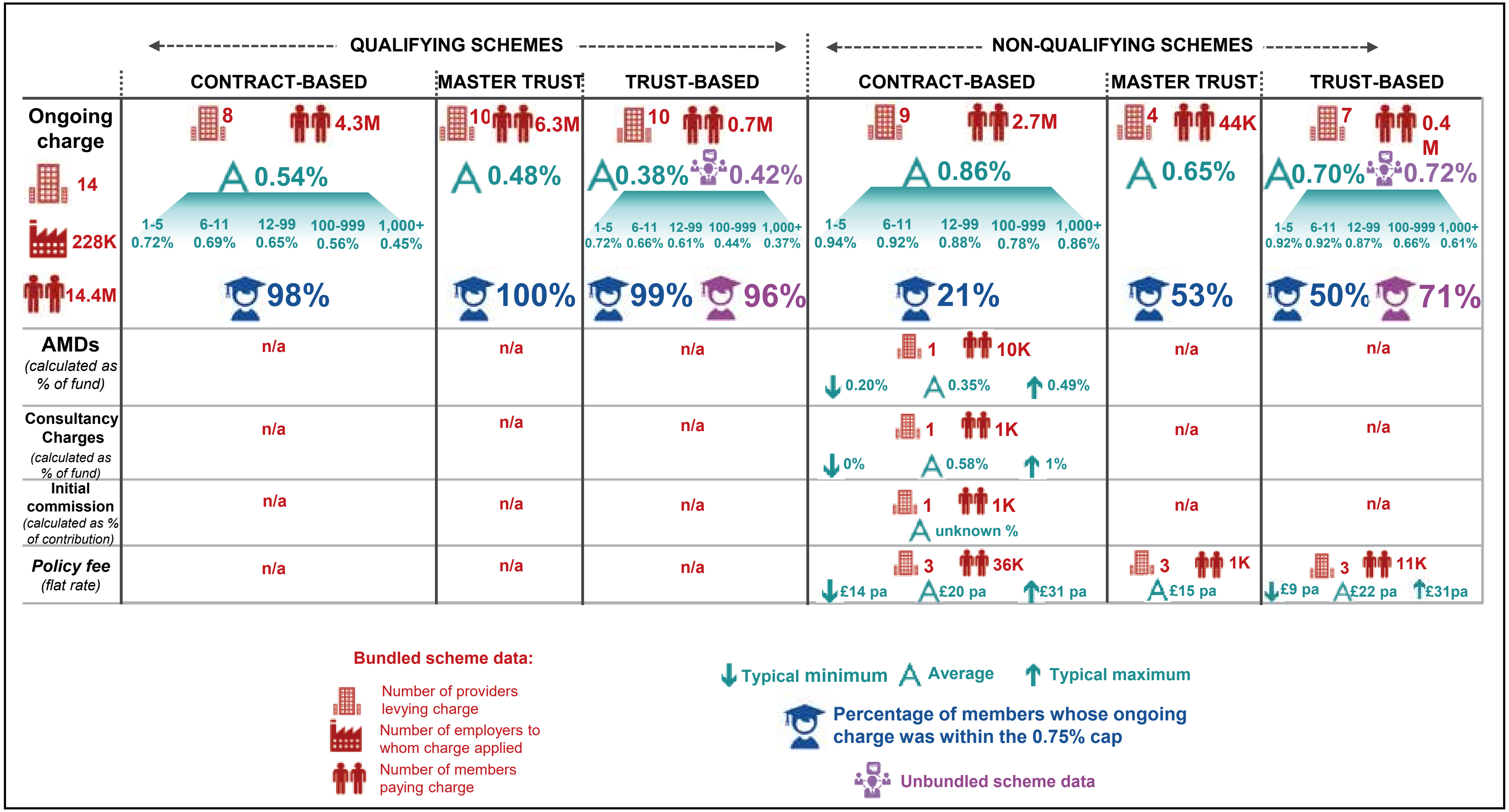
To the best of their knowledge and ability, providers were confident that they had been able to provide data for each of their DC workplace schemes that were open to new members, covering all of the types of charge that fell within the scope of the charge cap for qualifying[1] schemes.

Trustees of qualifying unbundled schemes also found it relatively easy to provide the charges data that we requested. In total, 80 per cent were able to report upon the ongoing charge paid by the members of their schemes; although this fell to just over half (53 per cent) of trustees of non-qualifying unbundled schemes.

The charges diagram overleaf summarises the charges paid by all members (whether active or deferred) after the implementation of the charge cap.

[1] A qualifying scheme is a scheme which is used by an employer to meet their legal duties around automatic enrolment.

Summary of the charges paid by members of qualifying and non-qualifying DC pension schemes



- Average figures marked by 'A' show the mean charge paid across all members. Even among qualifying schemes, a small proportion of members did not pay within the cap, because members of qualifying schemes who became inactive before 5 April 2015 are not subject to the cap.
- For contract-based and trust-based schemes, the average ongoing charge is further broken down by employer size.
- The figures in mauve denote unbundled trust-based schemes. These schemes' charges are not broken down by size because the limited population means that observations within each size category are too few.
- Consultancy charges, initial commission and flat fees levied, as well as any Active Member Discounts (AMDs) that were applied, are included within the ongoing charge figures and also itemised separately. Where contribution charges or flat rate charges were used as a combination charge structure across all the members of a master trust, these are incorporated into the ongoing charge but not presented separately.

Ongoing charges paid by members

The charge cap had lowered charges in qualifying schemes to the level of the cap or below:

- Members of qualifying contract-based schemes paid 0.54 per cent on average, with 98 per cent of members paying within the cap. Members of qualifying trust-based schemes paid 0.38 per cent on average, with 99 per cent of members paying within the cap.
- Among qualifying scheme members, the members of the smallest schemes, which previously charged higher than the cap, benefited the most. For example, ongoing charges for qualifying contract-based schemes with 12 or fewer members fell by 0.2 percentage points on average.

Non-qualifying schemes, whose charges are not subject to the cap and were already typically higher than it, had not generally brought down their charges in response. Non-qualifying schemes were typically older and sold in a less competitive and less heavily regulated environment:

- In non-qualifying contract-based schemes just 21 per cent of members paid charges within the cap; and in non-qualifying trust-based schemes 50 per cent of members paid within the cap – both showing little change since 2015.
- The average charge paid by non-qualifying contract-based scheme members was 0.86 per cent; and for members of non-qualifying trust-based schemes the average charge was 0.70 per cent. In both scheme types this charge rose to higher than 0.90 per cent in the smallest schemes.
- There was, however, a reduction in the number of non-qualifying scheme members paying the very highest levels of charge. Before April 2015, ten per cent of members of non-qualifying contract-based schemes had paid an ongoing charge of above one per cent. In 2016, fewer than one per cent of members paid such high charges.

Charges for unbundled trust-based schemes, measured for the first time in the 2016 survey, were typically comparable to their equivalent bundled trust-based schemes, although a relatively small number of closed, non-qualifying schemes charged markedly higher than the average.

The impact of the ban on legacy charges

'Legacy' charges that were banned under the charges measures (i.e. AMDs, consultancy charges and member-borne commission) had been eliminated from qualifying schemes by April 2016, and remained extremely rare even among non-qualifying schemes (where the charges measures did not apply):

- **AMDs:** In 2015, four of the 12 providers had used AMDs during the research period for qualifying contract-based schemes; all had now ceased, except one who kept them for a small number of non-qualifying schemes only. Two of these providers mentioned that they had lost revenue due to their lowering the charge for deferred members.
- **Consultancy charges:** Even in 2015, before the ban, only three providers used consultancy charges, and only for a small minority of members. By April 2016 only one provider still used them, for non-qualifying contract-based schemes only, and affecting around 1,000 members – a number that was said to be diminishing.
- **Initial commission:** Only one provider passed on initial commission to members in 2016, down from three in 2015. This affected around 40 employers with non-qualifying contract-based schemes only, which in turn impacted upon 1,300 members.
- **Trail commission:** In 2015, four providers had used trail commission in conjunction with qualifying contract-based schemes, affecting as many as ten to 20 per cent of such employers. In comparison, in 2016 only one provider still paid trail commission for qualifying schemes (contract- and trust-based) for contractual reasons. Due to the ban on member-borne commission this provider therefore needed to absorb that cost, since it could no longer be passed onto members.

Transaction costs

There was virtually no improvement in providers' abilities to report on transaction costs compared to 2015, with many providers, unbundled scheme trustees and their fund managers awaiting further guidance from the government:

- Only two were able to provide indicative data on how transaction costs for fund entry apply to their schemes: these typically led to a reduction of between 0.05 per cent and 0.40 per cent of each contribution.
- Only four providers could estimate the level of transaction costs for remaining invested. Typically, they ranged between zero per cent and 0.5 per cent of all members' total funds invested per annum, although one said that transaction costs could exceptionally increase to above one per cent in cases where there are property funds involved in the pension fund investment.
- Similar to the pension providers, most trustees of unbundled schemes could not report upon transaction costs, and were unclear about how to compile this information. In fact, some trustees admitted they were not clear what transaction costs were.

The impact of the cap on the pension landscape

Ensuring compliance with the cap had, unsurprisingly, been easier for providers whose charges were below the cap already. The biggest challenges had been faced by those providers who had a more complex fund structure and complicated default arrangements to bring below the cap: indeed, a minority of providers indicated that complying with the cap had substantially affected their revenue. Such providers also expressed concerns about the impacts that any possible further reduction in the level of the cap might have. They referred not just to the impact of the lower charge itself, but also to the disruption that further changes might cause if they needed to revise their schemes and systems again.

Overall, however, most providers acknowledged that the downward pressure on charges was part and parcel of the industry and current regulatory environment, and so would be likely to continue to some degree. This would require them to operate ever more efficiently, as well as to drive better deals from the fund managers themselves.

Providers were often concerned about the potential inclusion of transaction costs within the cap. While most welcomed industry-wide clarity in being able to report on transaction costs, capping them could, in the view of some, prevent fund managers from providing the best outcomes possible for members. A minority of trustees of unbundled schemes, who pursued relatively active investment strategies, were also concerned that the inclusion of transaction costs could restrict the number of transactions that they could make.

The full report of these research findings is published by the Department for Work and Pensions (ISBN 978 1 911003 83 0. Research Report 950. October 2017).

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