Title: Consultation Stage Impact Assessment on Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations **Lead department or agency:** Department for Work and Pensions	Impact Assessment (IA) **Date:** May 2021 **Stage:** Consultation **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries:** Grace Cassidy (Analysis) Neil Walker (Policy)

Summary: Intervention and Options

Cost of Preferred (or more likely) Option (in 2019 prices)			
Total Net Present Social Value	**Business Net Present Value**	**Net cost to business per year**	**Business Impact Target Status**
Not quantified	Not quantified	Not quantified	Qualifying provision

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

The Government is committed to ensuring that individuals who are automatically enrolled into a pension scheme are protected from high and unfair charges and are saving into schemes that are well run. In 2015, a number of charge related measures were introduced to protect members. This included the charge cap of 0.75 per cent on administration charges in the default funds of Defined Contribution (DC) workplace pension schemes used for automatic enrolment. Under the charge cap there are three permitted charging structures:

a) a single percentage charge, capped at 0.75 per cent of funds under management annually;
b) a combination of a percentage charge on each contribution plus an annual percentage charge of funds under management;
c) a combination of an annual flat fee plus an annual percentage of funds under management charge.

Following the Work and Pensions Select Committee meeting in 2019 on member borne charges in DC schemes, DWP agreed to their recommendation to review the level and scope of the cap as well as the permitted structures. This included considering whether flat fees should be applied to deferred pension pots.

The combination charge, levying both a percentage charge and a flat fee, is of concern because flat fees can continue to be levied on a pot irrespective of whether a member is continuing to make contributions. This means that all deferred members subject to flat fees could have their pots eroded over time. In the worst cases, where members have deferred, small pots, they may find their pot depleted to zero before they reach retirement. As noted by the Pensions Policy Institute, a flat fee in combination with a percentage charge will leave a £100 deferred pot depleted within six years. Meanwhile a percentage charge takes a percentage of pot size so can never reduce a pot to zero. For members not subject to flat fees there is no risk their pots will be depleted entirely.

The Small Pots Working Group report highlighted that making workplace pension saving the norm, especially for people who move jobs frequently, created an increased risk that an individual's pension savings could become fragmented into a number of deferred, small pension pots. Members with one or more deferred, small pension pots are at an increased risk of having their pot eroded by charges. Without intervention members being charged a flat fee would continue to see multiple pots at risk of depletion. Moreover, members with smaller active pots with lower contributions are also at risk of erosion. If the investment growth on these pots does not balance the flat fee charged to it there may be a number of smaller active pots at risk too.

The response to the consultation on the Review of the Default Fund Charge Cap and Standardised Cost Disclosure outlined the Government's priority to protect individuals who are automatically enrolled into a qualifying DC pension scheme from high and unfair charges and limit the risk of erosion to their pension savings from flat fees. **As a result, it was announced that a minimum level (or *de minimis*) would be introduced before a flat fee element of a charging structure could be applied to pots. This has been set at £100. The Government intends to implement this change from April 2022.**

What are the policy objectives of the action or intervention and the intended effects?

The introduction of a de minimis on the use of flat fees should limit the erosion of small pension pots by member borne charges and prevent any members from being charged out entirely. This measure would apply to pension pots in the default fund of Defined Contribution (DC) pension schemes. This should continue to protect members saving through workplace pensions from unfair charges and ensure value for money, especially for members with smaller or deferred pots. It should also ensure member's funds gain a degree of protection for when they reach retirement age. This policy is only applied to protect members who have not made an active choice on their fund, and are therefore within the default. Where members select their own fund it is assumed they are content with the charges and investment strategy offered by their chosen fund.

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

Policy Option 0: Do nothing. There is already one provider in the DC market who already has a de minimis on flat fees for deferred pots under £50. We are not aware of any other providers who would adopt this voluntarily. This option would sustain and increase the issue of pot erosion as labour market churn continues to increase the volumes of deferred pots over time, which will be financially detrimental to pension scheme members and could cause reputational damage to the pensions industry. A solution to the small pots issue is likely to take some time to develop and implement therefore without the de minimis small pots will continue to be eroded by flat fees.

Policy Option 1: Introducing a £100 de minimis. Introducing secondary legislation to implement a de minimis pot size below which flat fees cannot be charged in default fund schemes. All other ongoing fees and charges are applicable to these pots. We believe that a £100 de minimis is the correct level to set this to tackle the issue of pot erosion for pension savers, whilst at the same time enabling the newer master trust pension schemes to maintain financial sustainability over the short term. The Government needs to strike a balance between protecting members, especially those with small pots, and maintaining the financial sustainability of scheme providers. We have concluded that it is right to set the de minimis pot size at £100 as setting the de minimis higher than £100 may affect the financial viability of flat fee providers. Providers could continue to levy all other ongoing charges on these pension pots.

Policy Option 2: Introduce a tiered approach to enabling the charging of flat fees depending on the pot size. This could have meant no flat fee charge below £100 pot size, a maximum £5 charge on pots between £100 and £200, a maximum £10 on pots between £200 and £400, and so on. This option would provide protection to the largest number of small pots, however it could also have the greatest impact on those providers who rely on this charging structure by restricting their ability to charge flat fees on the greatest number of pots. In addition, this option increases complexity of charges, which has the potential to be more expensive for providers and potentially makes it harder for members and employers to understand the fees they pay.

Policy Option 3: Introduce guidance around the erosion of smaller pots by flat fees. A non-mandatory policy option; issuing guidance to pension providers to encourage them to look at whether their members are at risk of pot erosion by flat fee charges. This option would require no regulation or legislation and minimal burden on business. However, without regulation there is no obligation for providers who levy flat fees to follow this guidance so some members would still see their pots eroded to zero.

Policy Option 1 is our preferred option. **We are currently consulting on the secondary legalisation and there are some areas that still require clarification before we can begin costing. Therefore, this impact assessment will not include EANDCB or full costing and will outline the proposed benefits and costs to the affected groups. We are currently seeking further evidence to support costings of the de minimis.**

Does implementation go beyond minimum EU requirements?		N/A		
Is this measure likely to impact on international trade and investment?		No		
Are any of these organisations in scope?	**Micro** Yes	**Small** Yes	**Medium** Yes	**Large** Yes

What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)	**Traded:**	**Non-traded:**

Departmental Policy signoff (senior civil servant (SCS)):	David Bateman	Date: 15 March 2021
Economist signoff (senior analyst):	Joy Thompson – Deputy Chief Economist	Date: 19 March 2021
Better Regulation Unit signoff:	Prabhavati Mistry	Date: 17 March 2021

Summary: Analysis & Evidence Policy Option 1

Description: Limiting the use of Flat Fees in Defined Contribution Pension Schemes – introducing a level or *a de minimis* where pension schemes cannot levy flat fees on members. This would apply to all members in qualifying workplace pension schemes in the default fund.

FULL ECONOMIC ASSESSMENT

Price Base Year 2019	PV Base Year 2020	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:**

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

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

Pension Schemes In Scope

We do not expect there to be any costs for Defined Benefit (DB), Hybrid, or Defined Contribution (DC) schemes who do not levy a flat fee on members.

The Pension Charges Survey 2020 found that four out of the 20 pension providers surveyed used a combination charging structure that involved a flat fee, of which three were trust-based schemes so within the scope of this legislation. The Pension Charges Survey 2020 accounted for 29.3m pension pots and included all of the ten largest providers. However, some providers have adopted a flat fee since the survey was conducted. We assume the introduction of a de minimis would have a limited impact on the biggest providers, as the flat fee charging structures is still in the minority across DC large providers. We do not have evidence on the number of schemes outside the scope of the Charges Survey that use flat fees, and are looking to gather evidence on this as part of the consultation; in particular across small self-administered schemes.

We assume costs to these flat fee providers and schemes will include their trustees familiarising themselves with the regulations and accompanying statutory guidance as well as any necessary implementation costs. This may include data platform or infrastructure changes to identify the pots they can no longer charge. We are seeking further information on the familiarising, implementation and communication costs via the ongoing consultation.

Moreover, the de minimis on pots below £100 will mean schemes can no longer charge flat fees to these pots and will therefore face a drop in revenue, unless they make off-setting changes to charges elsewhere. They will be able to levy any other ongoing charges for example, percentage charges, and can continue to levy flat fees on pot sizes above £100 provided the average per member charge does not exceed the charge cap level of 0.75%.

At this stage we do not have a robust estimate for the number of members who will be directly impacted by the de minimis. We will seek to gather further evidence on this through and alongside the consultation process. At this stage the best estimate of the number of pots affected by the de minimis is the estimate based on the Small Pots Working Group Data. The estimates from the Pension Charges Survey 2020 are highly likely to be an undercount of the number of pots due to the lower flat-fee providers captured. This is discussed in further detailed below in Table 2 and Table 3.

Using the central estimate from the Small Pots Working Group would put our best estimate at around 1.2 million (Table 2). However, we know from the Pension Charges Survey 2020 that those providers using a flat-fee are more likely to be those with higher relative proportions of smaller pots, which suggests the estimate should be above 1.2 million. Without further evidence on the pot distribution for providers charging a flat fee we expect the numbers impacted to be between 1.2 million and 1.8 million; most likely towards the lower end of this range.

Charging a flat fee in combination, as opposed to a pure percentage charge, is the best way to generate revenue for a provider when pots are small and/or deferred, therefore we would expect providers selecting this charge structure to have a higher proportion of pots in scope of this measure than the averages given from the available data.

In order to estimate the impacts to members and providers we need the total number of pots impacted by the change. In the absence of a direct figure from this we can estimate it using:
- The total number of DC pots
- The percentage of these below £100 across the industry
- The proportion of pots with a provider charging a flat fee.

Members of Pension Schemes In Scope
According to the Pension Charges Survey 2020, the average ongoing charge is 0.48% which is below the charge cap level of 0.75% and market competition between providers was stated as a key factor in keeping the average charge so low.

We cannot be certain how any additional costs for affected providers may be passed on to members. There will be some providers who face a loss in revenue if they can no longer charge flat fees on pots less than £100. To recoup the loss in revenue, providers may choose to charge members with pots above £100 more, or alter their percentage charge, given that the majority of providers have room within the charge cap. According to the Pensions Policy Institutes report on Master Trust financial sustainability their annual expenditure has been growing year on year, with cumulative expenditure around £1 billion by 2019 and costs expected to continue to grow. The report also found the Master Trust industry is unlikely to achieve breakeven on costs until around 2025 and the potential loss in revenue may push this back further for the affected Master Trusts unless they increase their charges. Financial sustainability is a challenge for automatic enrolment providers and delaying paying back their loans may affect Master Trust ability to scale their assets, pursue innovation and prepare for future challenges and regulation.

Another Pensions Policy Institute report on charging structures defines cross-subsidies as a member paying more in charges than the costs incurred on their behalf, while at the same time a different member pays less in charges than the costs they incur. Cross-subsidies exist within all charging structures but are more common in single percentage charging structures. Using a flat fee can help reduce some of the cross-subsidy between larger and smaller pots. Removing this for smaller pots may increase the level of cross-subsidy in these providers.

We don't have evidence on the finances of those Master Trust who levy a flat fee and the extent of cross-subsidy between their members. If we assume they are representative, then they may seek to:

a) re-finance;
b) exit the market;
c) or increase charges on other groups;

in order to cover the loss of revenue from pots less than £100.

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

Impact on regulators
We do not expect there to be any additional costs to the pension regulators or the department. The cost of accommodating for the de minimis will be solely on providers and schemes. It is not our intention for the application of the de minimis to be part of any formal monitoring regime.

Cross subsidisation between pots
Flat fees can be used to mitigate the cross-subsidisation between smaller and larger pots. Whilst it is difficult to quantify the extent of cross subsidisation we may expect to see more pots affected if flat fees cannot be used to offset the expenses associated with managing smaller pots.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**

Best Estimate				

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

Impact on members

Small or deferred pot members

The introduction of a de minimis aims to protect the pension savings of members within schemes that levy a flat fee charging element. The Pension Charges Survey 2020 found the average flat fee ranged between £13 and £20 per annum and the highest flat fee levied was £36 per annum. This translated as an additional ongoing charge of between 0.14% and 0.22%. Members with pots in scope for the de minimis will save the flat fee amount each year until retirement. Members with multiple pots within the same provider will only benefit from the de minimis once. Providers should only levy a flat fee on an individual once regardless of the numbers of pots they may hold.

Small pension pots, particularly deferred pots, can be eroded by charging structures quickly. Analysis from the Wealth and Assets Survey found 12% of the sample reported owning two or more pension pots (Table 5). Moreover, 22% of the sample reported owning at least one (up to six) pot(s) and over 2% individuals reported having 3 or more pots (Table 5). Findings suggested small retained pots are found in highest numbers amongst females, those of lower earnings, and younger individuals (Table 7, 8 and 9).

The Pensions Policy Institute estimates there are around 8 million deferred pension pots. This is expected to rise to as many as 27 million by 2035. The Pensions Policy Institute's report into deferred pension pots noted a flat fee in combination with a percentage charge will leave a £100 deferred pot depleted within six years. This means that small deferred pots could, in a worst case scenario, have their pension pot entirely depleted by charges. The £100 de minimis is designed to limit pot erosion for these members and ensure that no member is left with a pot of zero.

Low earners

For members at the threshold for auto enrolment into a workplace pension schemes (£10,000 per annum), the average minimum monthly contribution (8%) would be around £25. The introduction of a £100 de minimis would protect around 4 to 5 months' worth of pension savings for the lower earners in auto enrolment.

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

Providers

Reputation

Since the introduction of auto enrolment more people are saving into workplace pensions mainly in the DC industry. It would negatively impact the reputation of the DC pension industry and workplace pensions if members' pots were entirely eroded by charges.

Key assumptions/sensitivities/risks	Discount rate (%)	

We currently have very limited data on the number of pensions pots in DC schemes with a value below £100. There is no existing data on the demographic composition of members who have pots below £100 but we can use analysis of pots in the Wealth and Assets Survey as a proxy for those who are more likely to have smaller pots. We will seek to gather further evidence to support costings of the de minimis.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target (qualifying provisions only) £m:
Costs:	Benefits:	Net:	

Evidence Base

The Policy Background

1. In 2015, the Government introduced the charge cap on all member-borne charges. The charge cap applies solely to the default fund of defined contribution (DC) schemes used for automatic enrolment. It covers all member-borne administration charges associated with scheme and investment administration excluding transaction costs and a small number of other specific costs and charges. This was designed to protect members from unfair charges, deliver value for money and improve transparency of costs and charges. The Pensions Regulator estimate over 17 million members are in schemes used for automatic enrolment and have therefore benefited from the introduction of the charge cap.

2. The charge cap is set at 0.75% and there are three permitted charges structures:
   a) a single percentage charge, capped at 0.75 per cent of funds under management annually;
   b) a combination of a percentage charge for new funds when they are contributed to the pot plus an annual percentage charge for funds under management;
   c) a combination of an annual flat fee plus an annual percentage of funds under management charge.

3. Different charging structures affect pension pots in different ways. There is evidence that flat fees from the Pensions Policy Institute, whether alone or in combination with other ongoing charges, erode pots quicker than other charging structures (as seen in Table 1). This can have a significant impact on smaller or deferred pension pots which can be eroded quickly, to zero if deferred, within a number of years.

Table 1: The Pensions Policy Institute modelling of different charging structures on deferred pot sizes

Charging structure	**Pot size at age 68**					
	Deferred at age 22			**Deferred at age 40**		
	£100	**£500**	**£1,000**	**£100**	**£500**	**£1,000**
Baseline – no charge	£300	£1,500	£3,000	£200	£1,000	£1,900
0.5% AMC only	£200	£1,200	£2,400	£200	£800	£1,700
£20 annual flat fee and 0.25% AMC	£0	£100	£1,400	£0	£200	£1,100
£24 annual flat fee only	£0	£0	£1,400	£0	£100	£1,100

Source: The Pensions Policy Institute

4. Within the DC pension industry, small pension pots affect both pension providers and members. For providers, the cost of servicing small pots can be in excess of the pot-level revenue generated. For members there is a risk their small pot can be eroded by charges, especially if the member is no longer paying into the pot. For members with one or more small pension pots, it could be possible that they could be subject to multiple pot erosion. This is bad for the reputation of the pension industry and workplace pension saving if members see their pots depleted entirely.

Rationale for Intervention

5. The Government is committed to ensuring that individuals who are automatically enrolled into a workplace pension scheme are protected from high and unfair charges and are saving into schemes that are well run. This includes ensuring pension savers get value for money from their workplace pensions.

6. In 2019, the Work and Pensions Select Committee heard evidence on charges in DC schemes and recommended the DWP review the level and scope of the cap as well as the permitted structures. This included considering whether flat fees should be applied to deferred pension pots.

7. The combination charge, levying both a percentage charge and a flat rate fee, is of concern because flat fees can continue to be levied on a pot irrespective of whether a member is continuing to make contributions. This means that all deferred members subject to flat fees could have their pots eroded over time by flat fees. In the worst cases, where members have small, deferred pots, they may find their pot depleted to zero before they reach retirement. For members not subject to flat fees there is no risk their pots will be depleted entirely.

8. As noted in the Small Pots Working Group report, making workplace pension saving the norm, especially for people who move jobs frequently, created an increased risk that an individual's pension savings could become fragmented into a number of deferred, small pension pots. Without further intervention, flat fees would continue to be charged on smaller pension pots and risk these being eroded further. In the worst cases, this may lead to some pots being eroded to zero.

9. The response to the consultation on the Review of the Default Fund Charge Cap and Standardised Cost Disclosure outlined the intention to limit the risk of erosion to their pension savings from flat fees. As a result, it was announced that a minimum level (or *de minimis*) would be introduced before a flat fee element of a charging structure could be applied to pots. This has initially been set at £100. The Government intends to implement this change from April 2022.

10. To assess the impact of the de minimis we have used the findings from:
    - The Pension Charges Survey 2020;
    - Wealth and Assets Survey;
    - Data from the Small Pots Working Group;
    - Analysis from the Pensions Policy Institute.

11. We are currently consulting on the secondary legalisation and there are some areas that still require clarification before we can begin costing. Therefore this impact assessment will not include EANDCB or full costing and will outline the propose benefits and costs to affected groups. We are seeking further evidence to support costings of the de minimis through and alongside the ongoing consultation.

Description of options considered

Policy Option 0: Do nothing

12. The Government has considered the option of not introducing regulation to limit the application of flat fee on pots less than £100. However, there are several reasons why the 'Do Nothing' option is not preferred. For this option there would be no cost to business but there would also be no benefit to members' pension pots.

13. If no de minimis is introduced some pension pots subject to flat fees will continue to be eroded. Whilst this would require no further introduction of regulation and pension schemes would not have to make any changes to their charging structures or governance, it does not prevent pots from being charged out.

14. The charge cap introduced through the Occupation Pension Schemes (Charges and Governance) Regulation 2015 should provide a level of protection to members and prevent unfair charging structures. However, there is evidence of member's pots being eroded despite the charge cap.

Policy Option 2: Introduce a tiered approach to enabling the charging of flat fees depending on the pots size.

15. The Government has considered the option of introducing a tiered approach to charging flat fees depending on pot size. In practice it would propose that there would be no flat fee charge below £100 pot size, a maximum £5 charge on pots between £100 and £200, a maximum £10 on pots between £200 and £400, and so on.

16. This option would provide protection to the largest number of small pots, however it could also have the greatest impact on those providers who rely on this charging structure by restricting

their ability to charge flat fees on the greatest number of pots. This option creates substantial administrative and infrastructural burden on providers to adapt systems to account for the tiered approach. Responses to the Review of the Default Fund Charge Cap and Standardised Cost Disclosure suggested a mechanism with different tiered limits would introduce complexity and would put a disproportionate burden on the administration of schemes.

17. Responses to the Review of the Default Fund Charge Cap and Standardised Cost Disclosure also noted there could be some difficulty in explaining this approach to members and how their pot may be affected over time.

Policy Option 3: Introduce guidance around the erosion of smaller pots by flat fees.

18. The Government has also considered a less comprehensive non-mandatory policy option; issuing further guidance to schemes on how to take into account for whether their members are at risk of pot erosion by flat fee charges.

19. This option would not confer any new responsibilities or duties on occupational pension schemes. Instead the guidance would be published by the Department with the objective of encouraging schemes to consider the impact of flat fees on small pension pots.

20. However, the lack of statutory weight behind the guidance would not be expected to result in the level of compliance and implementation that the policy objective requires. There would be no obligation for providers who levy flat fees to follow this guidance so some members would still see their pots eroded to zero.

Policy objective

21. The policy objective is to strike a balance between protecting members, especially those with small pots, and maintaining the financial sustainability of schemes. It is important to maintain public confidence in automatic enrolment and workplace pension saving and if pots continue to be eroded by flat fees there is significant concern this would damage their reputation.

22. The DC pensions market is still relatively immature and some providers are still in the process of paying back start up loans. These providers must balance delivering value for money for their members and their financial sustainability going forward.

23. Whilst the de minimis is not a long-term solution to the growing proliferation of small pots, any solution will take time. Many more pots may continue to be eroded by charges before a small pot solution can be implemented. Therefore, the de minimis will act as a level of protection whilst small pot consolidation is in progress.

Preferred Option – De minimis on flat fees

24. Our preferred option is the introduction of a level or de minimis where providers can no longer charge flat fees on pots. This will apply to all members in the default fund of qualifying schemes used for workplace pensions. We initially intend to set the de minimis at £100. Therefore any providers who levies flat fees on members in the default fund of a qualifying scheme used for workplace pensions will be affected.

25. The Government needs to strike a balance between protecting members, especially those with small pots, and maintaining the financial sustainability of scheme providers. We have concluded that it is right to set the de minimis pot size at £100 as setting the de minimis higher than £100 may affect the financial viability of flat fee providers

26. We intend to introduce secondary legislation to amend the Occupation Pension Schemes (Charges and Governance) Regulation 2015. We intend implementation to be April 2022 which should give any affected providers time to prepare.

Monetised and non-monetised costs and benefits of each option

Benefits to providers

Reputation

27. It is damaging to the success and reputation of auto enrolment and the workplace pension industry if members have their pots eroded significantly by charges. By ensuring members' pensions are protected from excessive charges it should help limit pot erosion and maintain the reputation of the DC pension industry.

De minimis already exists

28. Creative AE already have a de minimis in place for deferred pots less than £50. They charge an annual management charge 0.4% and a flat fee for active members (£2.00 per month) and for deferred members (£1.20 per month). For deferred members with a pension pot below £50 (or they pay in less than £5 a month) the £1.20 per month flat fee is waived. This means that it is feasible for schemes to introduce and maintain flat fees, a de minimis and financial stability.

Benefits to members

Small or deferred pot members

29. The introduction of a de minimis aims to protect the pension savings of members within schemes that levy a flat fee charging element. Small pension pots, particularly deferred pots, can be eroded by charging structures quickly. The Pensions Policy Institute estimates there are around 8 million deferred pension pots and this is expected to rise to 27 million by 2035. The de minimis should help limit erosion amongst deferred pots and provide long-term protection if the numbers of these pots continue to rise as predicted.

30. Findings from the Wealth and Assets Survey suggested small retained pots are found in highest numbers amongst females, those of lower earnings, and younger individuals (Table 7, 8 and 9). These are the groups who are most likely to benefit from the proposed policy.

Low earners

31. For members who are at the threshold for auto-enrolment into a workplace pension schemes (£10,000 per annum), the average minimum monthly contribution (8%) would be around £25. The introduction of a de minimis would protect around 4 to 5 months' worth of pension savings for the lower earners in auto enrolment.

Costs to providers

Defined Contribution providers

32. We do not expect there to be any costs for Defined Benefit (DB), hybrid, or Defined Contribution (DC) schemes who do not levy a flat fee on members.

33. Those who do not levy a flat fee will not have to familiarise themselves with new regulations because they will not apply to them. Schemes will know whether they use a flat-fee or not, and for those that don't we would expect them to quickly discount the new regulations meaning the cost to them is negligible.

Flat fee providers

34. The Pension Charges Survey 2020 found that four out of the 20 pension providers surveyed used a combination charging structure that involved a flat fee of which three were trust-based schemes within the scope of this legislation. The Pension Charges Survey 2020 accounted for 29.3m pension pots and included all of the ten largest providers. However, some providers have adopted a flat fee since the survey was conducted. We assume the introduction of a de minimis would have a limited impact on the biggest providers, as the flat fee charging structures is still in the minority at this size of scheme. We do not have any data on what proportion of the remainder of the DC industry charges a flat fee.

35. The introduction of a de minimis on pots below £100 will mean schemes can no longer charge flat fees to these pots and will therefore face a drop in revenue. However, they will be able to levy any other ongoing charges for example, percentage charges, and can continue to levy flat-fees on pot sizes above £100 provided the average per member charge does not exceed the charge cap level.

36. At this stage we do not have a robust estimate for the number of members who will be directly impacted by the de minimis. We will seek to gather further evidence on this through and alongside the

consultation process. This should enable us to quantify the loss of revenue to providers and savings to members. We do have some analysis on the distribution of pots in the DC Industry. Analysis of the Wealth and Assets Survey found around 4% of pots were worth under £100, although this is likely to be a significant underestimate. The survey relies on self-reporting so will not include any pots respondents have forgotten about, and only asks members for values of the two largest active pots and six largest deferred pots. It is a large scale questionnaire which may include data of DC pots from different types of scheme providers, including those who do not charge a flat fee. Analysis from the data provided by a sample of DC schemes to the Small Pots Working Group found 16% of pots were worth less than £100. This sample covered 15 million pots and included larger DC pension providers so it may be more representative of the true pot distribution than estimates based on the Wealth and Assets Survey estimate. However, the Small Pots Working Group data provides an indicative view of the size distribution of pots at a single point in time for five of the largest DC scheme providers only.

37. We can use some existing data sources on the number of pots including the Small Pots Working Group data collection and the Pension Charges Survey 2020. We have used these existing sources to provide transparency and construct our initial estimates of the number of pots affected.

Small Pots Working Group estimate

38. There were 20.2 million pots covered by the Small Pots Working Group data collection, of which an estimated 7 million were subject to flat fees. The Small Pots Working Group data collection found that of the overall total 25% of deferred pots, 6% of active pots, and 16% of active and deferred pots were worth less than £100.

39. If we assume the pot size distribution of the 7 million pots subject to flat fees is the same as the pot size distribution overall, we can estimate the number of pots affected by the de minimis. Table 2 below shows estimates based on this assumption, however there are a number of important reasons this is unlikely to hold in reality, which are outlined further below. We don't have a break-down of active and deferred pots, so have constructed estimates based on:
    - A high proportion of pots subject to flat fees – 25%
    - A medium proportion of pots subject to flat fees – 16%
    - A low proportion of pots subject to flat fees – 6%

Table 2: An estimate of the number of pots affected by the de minimis from the Small Pots Working Group data collection

	High (25%)	Medium (16%)	Low (6%)
Total number of pots worth less than £100 and subject to flat fees	1,800,000	1,200,000	400,000

40. As mentioned above, the data gathered via the Small Pots Working Group and used for these estimates should not be interpreted as a comprehensive or representative view of the wider DC pensions market. The data is unable to be quality assured by the Department, as the figures have come from an external source. Therefore, the data in the tables relies on the transparency of the self-reporting providers. The data also relates to the pot size and distribution at a fixed point in time. Given members may contribute, pots may be charged and investment returns may be added pot sizes may will have since changed.

Pension Charges Survey 2020 estimate

41. There were 29.3 million pots covered by the Pension Charges Survey 2020 across 20 pension providers, including the ten largest providers. We do not have an estimate of how many of these pots were subject to flat fees but three trust-based providers levied flat fees on their members. If we assume the 20 providers are representative, we could assume the three trust-based providers who levy flat fees cover around 4 million pots. Table 3 below shows estimates based

on this assumption, however there are a number of important reasons this is unlikely to hold in reality, which are outlined further below.

Table 3: An estimate of the number of pots affected by the de minimis from the Pension Charges Survey 2020

	High (25%)	Medium (16%)	Low (6%)
Total number of pots worth less than £100 and subject to flat fees	1,100,000	700,000	300,000

Charges Survey 2020 estimate

42. However, estimates based on the Pension Charges Survey 2020 assume all 20 providers captured are representative which is not true. These estimates assume only three providers levy flat fees when there are more in the wider market, meaning this approach is certain to undercount.

43. The Pension Charges Survey 2020 found providers used flat fees so they could:
- offset the short-term risk that new schemes pose before they begin to grow;
- manage small pots in a way that is economical for them.

44. Therefore we expect providers who charge a flat fee to have members with smaller pots sizes on average.

Conclusion

45. At this stage the best estimate of the number of pots affected by the de minimis is the estimate based on the Small Pots Working Group Data. The estimates from the Pension Charges Survey 2020 are highly likely to be an undercount of the number of pots due to the lower flat-fee providers captured.

46. Using the central estimate from the Small Pots Working Group would put our best estimate at around 1.2 million. However, we know from the Pension Charges Survey 2020 that those providers using a flat-fee are more likely to be those with higher relative proportions of smaller pots, which suggests the estimate should be above 1.2 million. Without further evidence on the pot distribution for providers charging a flat fee we expect the numbers impacted to be between 1.2 million and 1.8 million; most likely towards the lower end of this range.

    In order to estimate the impacts to members and providers we need the total number of pots impacted by the change. In the absence of a direct figure from this we can estimate it using:
    - The total number of DC pots
    - The percentage of these below £100 across the industry
    - The proportion of pots with a provider charging a flat fee.

Costs to members

Increased charges on other pots

47. To recoup the loss in revenue caused by the de minimis, affected providers may choose to charge members with pots above £100 more. According to the Pension Charges Survey 2020, the average ongoing charge is 0.48% which is below the charge cap level of 0.75%. Market competition was a key factor is why the charge was so low.

48. The Pensions Policy Institute defines cross-subsidies as a member paying more in charges than the costs incurred on their behalf, while at the same time a different member pays less in charges than the costs they incur. Cross-subsidies exist within all charging structures but are more common in single percentage charging structures. Using a flat fee can help reduce some of the cross-subsidy between larger and smaller pots.

49. The Pensions Policy Institute found in a Master Trusts that uses a proportion of fund charge, smaller pots are subsidised by larger pots. Inactive pots tend to be smaller than active pots. The increase in the ratio of inactive pots to active pots increases the extent to which active pots may

need to support the inactive pots. This type of cross-subsidy could increase if schemes can no longer charge flat fees on pots less than £100. This could be viewed as unfair to members who are continually saving into their pension pots having their contributions used to preserve the pots of others.

50. We cannot be sure how the added costs or loss in revenue to some provider may be passed onto members. Given that all members of qualifying schemes are below the cap and the average charge is fairly low, it could result in charges for members with pots larger than £100 increasing to subsidise the de minimis or the percentage charge rising for all members. Trustees have a fiduciary duty to act in the best interests of all their members and such changes would be made in the light of that overall duty.

Direct costs and benefits to business calculations

Costs to Pension Scheme in scope

51. The proposed elements of costs are divided into:
    - Familiarisation costs;
    - The costs of implementing the de minimis;
    - The cost of updating communications and charges information;
    - The loss of revenue.

52. We are seeking further information via and outside the ongoing consultation to outline any further costs we have not yet considered.

53. We do not expect there to be any costs for Defined Benefit (DB), hybrid, or Defined Contribution (DC) schemes who do not levy a flat fee on members. Only DC providers who levy a flat fee and provide qualifying workplace pensions will have to adopt the requirements of the new regulations for the de minimis.

Familiarisation

54. Only those providers directly affected by the de minimis will be expected to familiarise themselves with the regulations. There will be one-off familiarisation cost to schemes in scope for trustees to read guidance and understand the regulations for the de minimis. Our initial assumptions for these costs are outlined further below.

55. Once we have an estimate of the length of the requirements and statutory guidance we can estimate how much this may cost schemes.

Implementation costs

56. There will be some implementation costs to schemes to be able to identify those pots with less than £100. Then they will have to remove the flat fee charging element from these pots. This may require the amending or creation of platforms and infrastructure.

57. Providers can manage their schemes internally, via a third party or employer. Whether providers outsource this management will affect how costly implementing these changes are. For a scheme with good data management and platforms, they may be able to identify these pots quickly and make the necessary changes without incurring excessive additional costs. However, schemes who use third-party platforms may have to pay to amend their contract or ask their contractor to take on additional work.

58. We do not have an estimate of how much these implementation costs will be or the extent of work providers will need to undertake to be compliant. We are seeking information on these matters via the ongoing consultation and will seek to estimate this in the final stage impact assessment.

Communications

59. Affected providers will have to update their communications to reflect the introduction of a de minimis. Charges are often presented across a number of member communications including the provider's website, members statement or portal, and the Chair's statement.

60. We would expect providers to update any members affected by the de minimis directly to notify them that they will no longer be charged flat fees. We assume this would be in the form of a posted letter.

Loss of revenue

61. The introduction of a de minimis on pots below £100 will mean providers who levy flat fees can no longer charge these pots and will therefore face a drop in revenue. However, they will be able to levy any other ongoing charges for example, percentages charges, and can continue to levy flat-fees on pot sizes above £100 provided the average per member charge does not exceed the charge cap level.

62. The Pension Charges Survey 2020 found the average flat fee ranged between £13 and £20 per annum and the highest flat fee levied was £36 per annum. This translated as an additional ongoing charge of between 0.14% and 0.22%. Qualitative findings from the Pension Charges Survey 2020 found that one provider used a flat fee to offset the short-term risk that new schemes pose before they begin to grow and another used it to manage their small pots in a way that is economical for them.

63. Regardless of size, schemes and providers face costs in servicing and maintaining pension pots. Smaller pots still generate costs and bring in less revenue than larger pots. The Pensions Policy Institute assumes the cost of servicing an active pot is around £19.80 per annum and £13 per annum for a deferred pot. Providers may decide to offset this loss of revenue by increasing charges on pots larger than £100 although we do not expect providers to do this, as to do so could undermine the policy intention behind this change.

64. Master Trusts who relied on commercial loans and levy flat fees may be impacted by no longer being able to charge flat fees to pots less than £100. Their ability to service potentially quite large debts, would impact their financial sustainability.

Risks and assumptions

Data on flat fees

65. The Pension Charges Survey 2020 found four out of the 20 providers interviewed levied a flat fee. The Pension Charges Survey 2020 accounted for 29.3m pension pots and included all of the ten largest providers. Since this survey was conducted we are aware further providers have adopted a flat fee. There may be more providers outside the scope of this survey and our subsequent communications who levy flat fees on their members.

66. The Pension Charges Survey 2020 found the average flat fee charged ranged between £13 and £20 per annum depending on the provider. The highest charge was £36 per annum.

Data on members

67. It should also be noted that we have limited information on the types of members who hold the pots who will be impacted by the de minimis. Providers will have limited demographic information on their members and we expect them to share this via the ongoing consultation.

68. We have used the Wealth and Assets Survey as a proxy for the types of people who have smaller pension pots. The Wealth and Assets Survey is self-reported; therefore, it relies on accurate reporting of respondents which is not always the case. Some of the data cannot be directly compared with other sources.

69. The Wealth and Assets Survey will include data on DC pots from different types of scheme providers. We do not know whether the individuals in this survey are subject to flat fees. As with

any survey, findings are an estimate of those with small pots and are likely to undercount those with the smallest pots. Respondents are asked about the value of their two largest active and six largest deferred pots. It is likely that estimates will be an undercount and will not include any 'lost' or forgotten pots.

70. Some members lose contact with their pension pots over time and this can result in 'lost' pots. The Pensions Policy Institute estimates that just under two thirds (62%) of UK adults have multiple pensions. Among those with multiple pensions, 21% (more than 6.6 million people) are aware of having at least one lost pension pot. The Pensions Policy Institute believes there could be as many as 1.6 million lost pension pots, with a potential aggregate value of around £19.4 billion. Therefore it is likely any self-reported pension data, such as the Wealth and Assets Survey, may underestimate the number and value of pots given the scale of lost pots.

Assumptions for familiarisation

71. We have assumed only DC pension schemes within the scope of the regulations will need to familiarise themselves regardless of whether the de minimis will directly affect their charging structure.

72. We have assumed an average cost of an hour of time for a Trustee is £28.56 per hour, this is based on 2020 Annual Survey of Hours and Earnings (ASHE) data for Corporate Managers and Directors.

73. The median hourly gross pay for corporate managers and directors is £22.92. This is uplifted by 27% for overheads from the previous version of the Green Book, no updated estimate is available.

74. We also assume approximately 2.5 trustees per DC scheme, based on calculations using TPR data on 'Number of Trustees – by scheme type'.

75. For familiarisation costs we assume a reading time of 6 minutes per page for Trustees.

Assumptions for loss of revenue and savings to members

76. For providers who charge a flat fee there will be an inevitable loss of revenue. There is limited data on the number of pots with a value below £100 within DC pensions schemes.

77. Analysis from the data provided by a sample of DC schemes to the Small Pots Working Group found 16% of pots were worth less than £100 (Table 4). Analysis from the Wealth and Assets Survey found around 4% of pots were worth less than £100 (Table 6).

78. The Pension Charges Survey 2020 found the average flat fee charged ranged between £13 and £20 per annum depending on the provider. The highest charge was £36 per annum.

79. In order to estimate the impacts to members and providers we need the total number of pots impacted by the change. In the absence of a direct figure from this we can estimate it using:
    - The total number of DC pots within the scope of the Charge Cap;
    - The percentage of these below £100;
    - The proportion of pots with a provider charging a flat fee.

80. We don't have evidence on the finances of those providers who levy a flat fee and the extent of cross-subsidy between their members. If we assume they are representative, then they may seek to:
    a) re-finance;
    b) exit the market;
    c) or increase charges on other groups;

in order to cover the loss of revenue from pots less than £100.

Impact on small and micro businesses

81. The proposed regulations will impact any provider who operate a qualifying scheme used for workplace pensions and why levy a flat fee. This may include small and micro pension businesses although most small businesses do not administer their own pension schemes, but instead use an external provider to meet their duties.

82. We do not have evidence on the number of schemes outside the scope of the Charges Survey that use flat fees, and are looking to gather evidence on this as part of the consultation; in particular across small self-administered schemes. We will revisit the impact on small and micro business in greater detail in the final impact assessment.

Wider impacts

Member characteristics

83. We do not have data on the characteristics of those with pots less than £100 who pay flat fees. Analysis of the Wealth and Assets Survey (WAS) found small retained pots are found in the highest numbers amongst females, those of lower earnings, and younger individuals. There are caveats to this analysis but we can estimate these groups may benefit the most from the introduction of the de minimis.

84. For example, 85% of retained DC pots which belong to those aged 16-24 are worth less than £2500, compared to 57% of retained DC pots belonging to those aged 25-34, 31% of retained DC pots belonging to those aged 35-44, 26% of retained DC pots belonging to those aged 45-54 and 22% of retained DC pots belonging to those aged 55-64 (Table 9).

85. Moreover, 43% of retained DC pots which belong to individuals with income between £10,000-£19,999.99, are worth less than £2500. The corresponding figure is 34% of retained DC pots for income group £40,000-£49,999.99 (Table 8).

Member engagement

86. Responses to the Review of the Default Fund Charge Cap and Standardised Cost Disclosure suggested the introduction of a de minimis may disincentive members from consolidating their smaller pots as they are at less of a risk of pot erosion.

87. However, member engagement with their workplace pensions remains low. The Financial Conduct Authority's (FCA) 2017 Financial Lives Survey found that almost half (45 per cent) of people state that they do not give their pension 'much thought' until they are two years from retirement - commonly citing a lack of time.

88. Many members do not make active choices about their workplace pensions. According to the Pensions Regulator, around 95% of memberships in DC schemes are invested in the scheme's default strategy. The Pension Policy Institute found this was even higher for members in Master Trust scheme with an estimated 99% in the default strategy.

89. This evidence suggests the majority of members in DC schemes do not make active choices about how their pensions are managed. Therefore, we would not expect the introduction of a de minimis to significantly impact members' decision to consolidate their pots.

Monitoring and Evaluation

90. DWP Policy officials will be responsible for monitoring the impact of this change. We are considering developing proportionate evaluation plans alongside the policy development.

91. A review of the de minimis to consider how well it operates and if its level should be changed in the future will be undertaken in due course.

Annex

Annex A: Analysis from Small Pots Working Group data collection with DC providers

In total, five schemes were contacted and shared their data. These were predominantly Master Trust schemes with one scheme including data for the Group Personal Pension (GPP) schemes they manage alongside their master trust business. The schemes were selected for the exercise based on their large size (estimated total number of accounts) and significant automatic enrolment customer base.
The data gathered should not be interpreted as a comprehensive or representative view of the wider DC pensions market.

All individual level scheme data was shared with the Department on a confidential basis due to its commercial sensitivity and will remain anonymous. The data is unable to be quality assured by the Department, as the figures have come from an external source. Therefore, the data in the tables relies on the transparency of the self-reporting providers. The data refers to August - September 2020. In total, the data presented encompasses 20 million pension pots. The distribution shown in Table 3 is based upon a smaller sample of 15 million pots.

Table 4: Distribution of active and deferred pension pots in sample of DC schemes by £100 size band.

Pot size	Aggregate percentage of active pots by £100 size band below £1,000	Aggregate percentage of deferred pots by £100 size band below £1,000	Aggregate percentage of pots by £100 size band below £1,000
£0 - 99	6%	25%	16%
£100 - 199	5%	13%	9%
£200 - 299	4%	9%	6%
£300 - 399	3%	7%	5%
£400 - 499	3%	5%	4%
£500 - 599	3%	4%	3%
£600 - 699	3%	3%	3%
£700 - 799	2%	3%	3%
£800 - 899	2%	2%	2%
£900 - 999	2%	2%	2%
£,1000+	67%	26%	45%

Annex B: Analysis from the Wealth and Assets Survey

The Wealth and Assets Survey is a large-scale national longitudinal survey of private households in Great Britain. The survey uses Postcode Address File (PAF) as the sampling frame, and to ensure that the sample is representative of the GB population, 'probability proportional to size' sampling technique is used. Interviews are conducted using Computer Assisted Personal Interviewing (CAPI), and collect detailed information on individual and household wealth in various forms. The analysis presented uses data from Round 6 of the survey which was conducted over a period between April 2016 to March 2018. Overall, 18,400 households were interviewed in Wave 5 of the survey and 16,000 in Round 6.

The data on occupational DC pot size is self-reported and is only based on an individual's two largest occupational DC pots. Therefore, some smaller pots could be missing from the analysis. In addition, as it is self-reported, where an individual has forgotten or "lost" a pension pot they necessarily will not report it and it will not appear in the data.

Table 5: Percentage of active and deferred pots individuals, aged over 16, reported owning

Number of pots	Percentage
0	61.0%
1	26.7%
2	8.0%
3	2.8%
4	1.0%
5	0.3%
6 or more	0.1%

Note: Frequency and percentages rounded.

Table 6: Distribution of active and deferred pots individuals, aged over 16, reported owning by £100 size band.

Pot size	Percent
Under £100	4.2%
£100-£199	2.5%
£200-£299	3.2%
£300-£399	1.4%
£400-499	1.1%
Over £500	87.5%
Total	100.0%

Note: Percentages rounded. Respondents only asked about their 2 largest active pots and 6 largest deferred pots.

Table 7: Distribution of active and deferred pots individuals, aged over 16, reported owning by £500 size band and gender.

Pot size	Female	Male
Less than £500	14.7%	10.7%
£500-£999	7.5%	5.8%
£1,000-£1,499	9.6%	7.4%
£1,500-£1,999	3.0%	2.6%
£2,000-£2,499	5.5%	4.4%
Over £2,500	59.7%	69.2%
Total	100%	100%

Note: Percentages rounded. Includes only respondents who reported owning a pension. Respondents only asked about their 2 largest active pots and 6 largest deferred pots.

Table 8: Distribution of active and deferred pots individuals, aged over 16, reported owning by £500 size band and income.

Pot size	Less than £10,000	£10,000-£19,999	£20,000-£29,999	£30,000-£39,999	£40,000-£49,999	Over £50,000
Less than £500	5.3%	16.7%	15.2%	14.6%	13.0%	11.8%
£500-£999	3.4%	8.2%	6.3%	8.2%	5.9%	6.5%
£1,000-£1,499	6.5%	10.0%	11.8%	10.1%	8.2%	7.7%
£1,500-£1,999	1.9%	2.4%	3.5%	3.6%	3.2%	2.8%
£2,000-£2,499	4.6%	6.2%	6.3%	4.6%	4.0%	4.7%

Over £2,500	78.3%	56.5%	57.0%	58.9%	65.8%	66.6%
Total	100%	100%	100%	100%	100%	100%

Note: Percentages rounded. Includes only respondents who reported owning a pension. Respondents only asked about their 2 largest active pots and 6 largest deferred pots.

Table 9: Distribution of active and deferred pots individuals, aged over 16, reported owning by £500 size and age band.

Pot size	16-24	25-34	35-44	45-54	55-64
Less than £500	38.8%	20.0%	9.7%	9.4%	8.2%
£500-£999	22.2%	13.9%	4.6%	3.7%	3.4%
£1,000-£1,499	11.1%	12.1%	8.7%	6.8%	6.1%
£1,500-£1,999	5.4%	5.1%	2.2%	2.2%	1.8%
£2,000-£2,499	7.3%	5.7%	6.0%	4.3%	3.0%
Over £2,500	15.1%	43.1%	68.7%	73.6%	77.6%
Total	100%	100%	100%	100%	100%

Note: Percentages rounded. Includes only respondents who reported owning a pension. Respondents only asked about their 2 largest active pots and 6 largest deferred pots.