# Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations

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| **Lead department** | Department for Work and Pensions |
| **Summary of proposal** | Providers of defined contribution pension plans used for automatic enrolment which levy flat fees on members in the default fund (the "specified schemes") will not be permitted to charge flat fees on members' pension pots which have an aggregate value of £100 or less. |
| **Submission type** | Impact assessment (IA) – 28 September 2021 |
| **Legislation type** | Secondary legislation |
| **Implementation date** | April 2022 |
| **Policy stage** | Final |
| **RPC reference** | RPC-DWP-5108(1) |
| **Opinion type** | Formal |
| **Date of issue** | 28 October 2021 |

## RPC opinion

| **Rating**[1] | **RPC opinion** |
|---|---|
| Fit for purpose | The EANDCB appears to be based on proportionate evidence and correctly classifies impacts on business. The IA would benefit from further discussion of competition impacts and a much stronger monitoring and evaluation plan. |

## Business impact target assessment

| | **Department assessment** | **RPC validated** |
|---|---|---|
| **Classification** | Qualifying regulatory provision | Qualifying regulatory provision |
| **Equivalent annual net direct cost to business (EANDCB)** | £6.6 million | £6.6 million |
| **Business impact target (BIT) score** | £32.8 million | £33.0 million |
| **Business net present value** | -£56.5 million | |
| **Overall net present value** | -£2.0 million | |

[1] The RPC opinion rating is based only on the robustness of the EANDCB and quality of the SaMBA, as set out in the Better Regulation Framework. The RPC rating is fit for purpose or not fit for purpose.

# RPC summary

| Category | Quality | RPC comments |
|---|---|---|
| EANDCB | **Green** | The EANDCB appears to be based on proportionate evidence and correctly classifies impacts on business. There is a good discussion of the counterfactual. |
| Small and micro business assessment (SaMBA) | **Green** | Based on consultation, the Department believes that none of the schemes in scope of the policy are likely to be operated by small or micro businesses (SMBs). |
| Rationale and options | **Satisfactory** | The IA presents evidence to support the rationale for the preferred option based on an equity argument for intervening to protect members with small pension pots from erosion arising from flat fees.  It also assesses a non-regulatory option, but the IA would benefit from seeking to quantify the likely impacts of that option rather than discounting them as optional. |
| Cost-benefit analysis | **Satisfactory** | The IA draws upon a range of evidence and includes a useful sensitivity analysis. It would benefit in places from further justifying the use of assumptions and evidence from previous impact assessments. |
| Wider impacts | **Weak** | The IA would benefit from further discussion of potential impacts on financial sustainability of the affected providers and schemes, and consequent possible impacts on competition. |
| Monitoring and evaluation plan | **Very weak** | The IA would benefit significantly from setting out how the proposal will be monitored and evaluated, including what data might need to be collected. |

# Summary of proposal

The policy objective is to limit the erosion of small pension pots by flat fee charges and prevent any members from being charged out entirely by flat fees, i.e. left with nothing in their pension pot. The proposal introduces threshold of £100 at or below which a provider can no longer charge flat fees on a small pension pot. This policy would apply to the pension pots of all members of the specified schemes. Where the sum total of a member's pension pot or pots with a provider is at £100 or below, then the provider would not be permitted to charge flat fees to that member.

Based on the Pension Charges Survey 2020 and consultation responses, the Department estimates that six providers will be impacted by the proposal. Based on the information from these providers, the Department estimates that around 1.5 million pension pots worth £100 or below are currently subject to flat fees.

The IA estimates an EANDCB of £6.6 million (2019 prices; 2020 present value base year). Nearly all of this cost is accounted for by loss of fee revenue to providers, estimated at £6.3 million per year. This figure is estimated from data supplied by providers and adjusted on Pension Policy Institute data on the proportion of pots belonging to the same member. (Providers are only currently permitted to levy a flat fee on an individual member once, regardless of the number of pots they may hold with that provider). The EANDCB also includes one-off administrative costs to providers for familiarisation, system changes and communications (£2.0 million). Because the loss of revenue to providers is matched by an equivalent gain to members (absent any cross-subsidisation – see "EANDCB, Indirect Costs" below), the one-off resource costs account for the societal NPV of -£2.0 million.

# EANDCB

The EANDCB appears to be based upon proportionate evidence and covers the significant direct impacts on business.

Counterfactual/baseline

The IA includes a good discussion of the counterfactual, drawing upon further data and evidence indicating whether the overall stock of pots of £100 or less would be expected to increase or decrease over time (paragraphs 68-77).

Indirect impacts

The IA notes that the preferred option may have an indirect impact on other members in the specified schemes, if the affected providers seek to pass on to members generally the costs of no longer being able to charge flat fees on small pension pots. The IA does not monetise this cost to members but it does provide a useful discussion of cross-subsidisation of members with smaller pension pots by members with larger pension pots and how the proposed policy could increase this situation. (pages 18-19). However, it also notes that some providers might not seek to pass on these costs to other members, due to competitive pressures.

See also comments under ‘Cost benefit analysis’ below.

# SaMBA

The IA notes, using the Pension Charges Survey 2020, that SMBs which operate specified schemes are unlikely to use flat fee structures and that none of the six providers identified as being affected are SMBs. The SaMBA would benefit from a discussion of whether the proposal could affect market entry by SMBs.

# Rationale and options

The IA’s main rationale for intervention is based on equity considerations, as studies indicate that members with small pension pots more likely to belong to individuals on low incomes and in more precarious forms of work.

The IA states that it is believes that a *“…£100 de minimis strikes the right balance between tackling the issue of pot erosion for pension scheme members, whilst at the same time enabling the newer master trust pension schemes to maintain financial sustainability over the short term as their membership builds up and generates increasing revenue.*” (page 1). However, the IA would benefit significantly from providing further justification for the particular form and level of the threshold. This should address:

- how the £100 figure was arrived at;
- whether a taper was considered as an alternative to a ‘cliff-edge’;
- whether the value of multiple small pots could be eroded more quickly under a proportionate fee; and
- incentives for providers to get members to aggregate their pots to one pot of more than £100 in value.

The IA includes a non-regulatory option of introducing guidance around the erosion of smaller pots by flat fees. This option is rejected as it “…*would be unlikely to result in the level of compliance and implementation that the policy objective requires*.” (paragraph 25, page 9). The IA refers to The Pensions Regulator research on the Defined Benefit Funding Code of Practice in support of this. The IA would benefit from further discussion of this research, as the figures quoted (92% of trustees having read the DB code of practice or summary and 64% having carried out all five of the activities) suggest that guidance could have a significant impact. More generally, the IA could be improved by estimating the likely ‘take-up’ of the guidance and scale of associated costs and benefits, relative to the preferred regulatory option. Although these impacts would be excluded from the EANDCB on the basis they are “optional” (table on page 11), they should be considered as part of the analysis of the non-regulatory option.

# Cost-benefit analysis

<u>Evidence and data</u>

The IA draws upon a range of evidence, including the consultation responses, direct engagement with affected providers, survey data and analysis from the Pensions Policy Institute. It relies on assumptions and evidence from previous impact assessments in a number of places (e.g. paragraphs 29 and 42). This approach seems proportionate in this case but the IA would benefit from discussing whether more up-to-date actual data are available.

<u>Assumptions</u>

The IA notes that providers may incur additional ongoing testing of the system in the future but regards these costs as "…*optional and part of the running costs of pension administration regardless of the implementation of the de minimis*." (paragraph 56, page 13). This conclusion appears to be reasonable but the IA could usefully describe any supporting evidence for it obtained from the consultation or stakeholder engagement.

<u>Risk and uncertainty</u>

The IA includes a useful sensitivity analysis and helpfully applies optimism bias adjustments to the system changes costs.

The assessment of risk and uncertainty could be improved by:

- explaining why a 50% decrease or increase is appropriate;
- providing further supporting evidence for the assumption that only those providers using flat fees are likely to be materially affected, given that the policy would result in a much greater one-off impact if all pension schemes incurred familiarisation costs; and
- why it is appropriate to apply the equipment/development optimism bias adjustment to communication costs.

The analysis would also be improved by considering to what extent providers might be able to mitigate any loss of flat fees by increasing their percentage charges (taking into account the restrictions introduced in 2015) and the effect any such increase might have on members with small pension pots.

# Wider impacts

The IA includes a section on wider impacts, including a short discussion on 'market competition' which notes that the policy may put the affected providers at a competitive disadvantage to other providers which do not levy a flat fee. The IA would benefit significantly from discussing further any potential implications of this competition impact, such as risks of affected providers exiting the market. Assessing potential impacts on competition appears important as the IA refers to evidence of competition between providers being a significant factor in driving down average charges. As the IA notes, the DC pension market is still relatively immature and some providers are still in the process of recovering their start-up costs, the discussion could usefully consider how the policy might impact on the financial viability of the affected providers and the specified schemes.

# Monitoring and evaluation plan

The Department does not plan to undertake a specific review of the policy but the IA indicates it will be considered in conjunction with other policies in this area. It also refers to considering opportunities to undertake informal evaluation of the policy.

The IA should explain in more detail why the Department is not planning to review this specific policy measure. Whilst acknowledging the interactions with other measures, the IA would benefit significantly from setting out how this specific policy will be monitored and evaluated as part of any wider policy measures, including what data might need to be collected to determine whether the policy has been effective in achieving its objectives and the likely timeframe for any such review.

**Regulatory Policy Committee**

For further information, please contact regulatoryenquiries@rpc.gov.uk. Follow us on Twitter @RPC_Gov_UK, LinkedIn or consult our website www.gov.uk/rpc.