PENSIONS POLICY INSTITUTE
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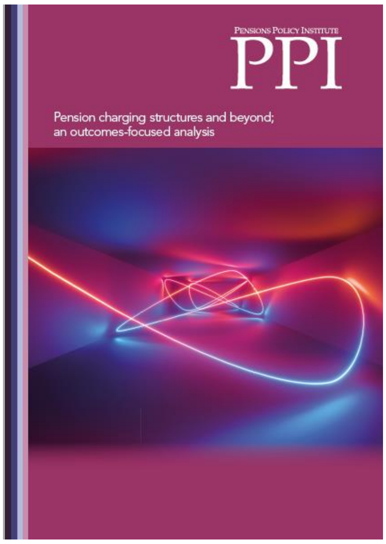
Pension charging structures and beyond; an outcomes-focused analysis

Launch write up



The Pensions Policy Institute (PPI) held a policy seminar on 11th September 2019 to launch ***Pension charging structures and beyond; an outcomes-focused analysis***, sponsored by Smart Pension. The event was kindly hosted by Which?. Pension charging structures and beyond; an outcomes-focused analysis examines the extent to which charging structures affect savers' retirement outcomes and what more could be done to aid people to have a retirement outcome that meets their needs. The report is framed in the context of the success of automatic enrolment which has seen significant expansion in the numbers of people saving into workplace pensions, and the introduction of the charge cap on default schemes has focused attention on charges, transparency and value for money.

Over 50 people representing a broad range of interests within Government, the investment industry, the pensions industry and the third sector attended the seminar.

Mel Duffield, Pensions Strategy Executive, USS and PPI Governor, chaired the event.

Mark Baker, Senior Policy Researcher, PPI, presented the findings of the research: Charging structures and levels do have an important role to play in determining savers' retirement outcomes, but they should be understood alongside a number of other factors, such as contribution levels, investment strategies, the impact of accumulating multiple pots, the strength of governance oversight and member communications and experience.

Darren Philp, Director of Policy and Communications, Smart Pension, responded to the report and considered the attention paid to charging both currently and historically which has led to too much focus at a disproportionate degree of detail. There are pros and cons to any charging approach and when considering what is best to the member the answer becomes "it depends". A focus upon good governance and consolidation can help employers and members.

Alastair Reed, Senior Policy Adviser – Money, Which?, reflected upon the communication to members of the charges they have paid and the impact this may have upon behaviour. While current inertia implies the impact may be limited, ignorance and inertia is not a state that can be accepted in light of pension freedoms.

Rob Yuille, Head of Long-Term Savings Policy, ABI, lamented the current state of the charging debate and wished for a more holistic and rational take upon the matter. Providers ultimately will decide between cross-subsidies and cost-reflective charges, driven by a trade-off between simplicity and fairness, and when considering outcomes there are more important factors than charges. There are intangible factors in value for money which cannot be directly compared, so while we consider what can be measured we should not forget the subjective.

David Farrar, Investment and Governance Manager, DWP, appreciated the value of the report to the statutory 2020 automatic enrolment review (which will consider both the charge cap and permissible charging structures). He observed that too much focus on charges is better than not enough and the inherent conflict between fairness and simplicity. There is an opportunity for action upon consolidation, removing eggs from the dashboard basket, however there is a challenging balance to all consolidation options.

Panel discussion and Q&A

The following points were raised during the panel discussion chaired by Mel Duffield and Q&A session, held under the Chatham House rule. They do not necessarily reflect the views of the Pensions Policy Institute or all panellists.

The following themes of discussion emerged:

The place of charges in value for money

- Value for money comprises: charges; performance; intangibles.
- Charges
  - Transparency is essential to assess charges.
  - Charges need to be linked to costs.
  - Individual charges are often seen as a proxy for costs, however they may not be directly linked.
- Performance
  - Scrutiny of investment performance is generally missing.
  - Risk of focus on past or non-indicative investment performance.

  - Trustee knowledge and governance standards are good indicators of future performance.
- Intangibles
  - Factors should not be traded off against one another.
  - Consumers may not have the understanding or engagement to understand the nuances and act upon it appropriately.

Cross-subsidies

- They are inevitable.
- There is a trade-off between simplicity and fairness (a recurring theme of the debate).
- Scheme design assumes that there will be sufficient large pots to subsidise small pots. A reduction in small pots, through some form of consolidation, should lead to a reduction in cross-subsidies and could lead to a more efficient market.
- Cross subsidies can be a good thing, they support public policy goals helping people into saving and are generally redistributive.
- At some level cross-subsidies can be regarded as a cross subsidy from your future self.
- If cross-subsidies are unavailable this can disrupt business models and disadvantage people when they start to save with very high charges compared to fund values.

Communications, disclosure and messaging

- Different degrees of information associated with different pieces of communication are needed for different audiences (members, trustees, employers, IGCs etc.).
- Fund factsheets, which include historical fund performance, exist but are not penetrable to members.
- The Chair's Statement has become onerous as compliance with the guidance has been overly cautious. Dialogue is required to realign the intent and interpretation of the guidance.
- Information must be made available as it may be seen as something to hide.
- Schemes may need to engage employers more, rather than primarily their members.

Appropriateness of schemes for members

- The focus of scheme selection has changed throughout the staging process:
  - Larger employers focussed on scheme selection based on member outcomes;
  - Smaller employers focussed on the ease of implementation of a scheme.
- While guidance says employers should pick a suitable scheme for their employees they may not have a typical employee.
- Smaller employers will be more reliant on IGCs / trustees to look after members as they are less likely to review their pension choice.
- Schemes will typically focus on an 'average' member and the membership heterogeneity may be missed.

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The drive to low charges

- UK charges are low by international standards.
- People may be put off from paying higher or additional charges for more expensive services (e.g. alternative asset investment) if charges are directly linked to costs.
- Itemised charging can lead to a sense of unfairness when it is levied for access to your own funds.

Consolidation

- An approach driven by member engagement rather than pot follow member is favoured, however different people at different times may be better served by an alternative mechanism.
- There are significant barriers to consolidation, not helped by low engagement and the fact that it currently has to be driven by a member.
- Transfer rates in and out of Nest are increasing, implying an increasing (but still low) member desire to consolidate.

Further implications of the current charging environment

- Accumulation charging is setting expectations of charging in decumulation.
    - However, drawdown costs more to administer than an accumulation fund.
- Charging structures have implications for reserving requirements under mastertrust authorisation.