PENSIONS POLICY INSTITUTE

PPI

What is the impact on member outcomes of different non-capped charging structures? A PPI Launch Event

The Pensions Policy Institute (PPI) held a launch event on 24 November 2021 to launch the PPI report **What is the impact on member outcomes of different non-capped charging structures?** This report, sponsored by B&CE, provides an international perspective to the current UK debate around funds with uncapped charges in pensions.

The event was run as an online seminar with the key findings presented by lead researcher Tim Pike (PPI Head of Modelling) with responses from the sponsor Philip Brown (B&CE, Director of Policy and External Affairs). Around 40 people attended this event, representing a broad range of interests within Government, the investment industry, the pensions industry and the third sector attended the seminar. Josephine Cumbo (PPI Governor and Financial Times) chaired the event.

Presentation of key findings

Josephine Cumbo welcomed everyone to the event, she thanked B&CE for sponsoring the research and introduced the research report, setting out the policy environment around uncapped charges. She then introduced Tim Pike (PPI) to share the findings of the report.

Tim Pike, Head of Modelling, PPI, presented the key findings of the research. He thanked the sponsor and set out the scope of the research, presenting a roadmap of his presentation, setting out the research question behind the report and the areas of consideration in the report. These are:

Automatic enrolment and charge caps

Tim gave the background to the charge cap, highlighting that the cap was brought in a few years after the introduction of Automatic Enrolment in an attempt to drive value for money and thereby make decisions easier for employers selecting a scheme for their employees.

He described the current landscape of schemes, where 95% of members in master trusts are in the scheme's default fund, which is where the charge cap applies. He showed that the average pot sizes of these members were fairly small (around £350) and that if charges were levied at the full charge cap, was charged over the lifetime of the pension, the erosion could be around 20% of the theoretical savings.

Tim explained that from April 2022 the cap is due to be changed, with a de minimis level of £100 pot size under which a flat fee may not be charged.

The Moving members

Savers were brought into pensions through charge capped automatic enrolment funds. The decisions about the scheme are made by the employer, who may often be driven by ease of administrative factors rather than the charges applicable to members. The members themselves have not, at the point they are enrolled, engaged with the value for money of the scheme or charging structure.

He explained that if members leave their charge capped arrangement they may have diverse reasons for doing so, including but not limited to searching for higher returns, personal control of their savings etc. Choosing a non-default fund leads to charges based on fund selection rather than the capped charge. Tim suggested that considering performance net of charges allows for strategies to be compared on a like-for-like basis.

The effect of oversight and competitive pressure

Tim went on to discuss the evolution of charges in DC funds that fall outside of the charge capped environment. He noted that legacy DC schemes (those that existed before the introduction of automatic enrolment) have seen charges fall to the point that 86% of legacy scheme assets are charged at a level below the AE charge cap. However, he commented that there remains a charging gap between AE schemes and those outside of the charge cap, meaning that for a member to achieve additional value from transferring they must release some additional benefit.

Trade-offs

Tim then discussed the trade offs made with a transfer. First, he highlighted what could be a severe downside, that employer contributions could be lost. Employer contributions which are typically only made to the arrangement the employer set up, moving away from that arrangement could lose the employer contributions. He also spoke of the costs and charges associated with moving outside the capped environment. However, he noted that while the average charges are higher, the particular charges where the individual decides to save may not be, and if the member was subject to multiple flat fees from having pensions spread out, consolidating into one pot may reduce fees.

He discussed potential benefits of consolidating multiple pension pots, allowing easier management and control for an individual, and ensuring that smaller pots are not lost. He also discussed the more customisable options available outside of default schemes such as access flexibility and investment options.

Tim then tied the section together by noting that charges are just one element of why people may choose to transfer between DC arrangements or choose to stay in a default.

Consultations and policy

Tim then discussed the future direction of travel, reflecting first on the future policy for capped charges. He discussed the upcoming de minimis on flat fees and how that may affect cross subsidies and implementation costs.

He went on to consider cost transparencies, including an industry led initiative aimed at helping members understand the charges and fund performance to make better decisions. He mentioned that while industry was working toward cost transparency, the Government has said it may intervene with legislation if uptake of the initiative is not considered sufficient.

Tim then discussed the Government's proposal of a single charging structure in automatic enrolment schemes. He explained that the aim would be to simplify comparisons and make charges easier to understand, but noted that providers who cater to small pots would be at a disadvantage with a de minimis structure in place and could present barriers to entry to the market.

Competition

Tim discussed the advantages that schemes operating as consolidator vehicles have over those that operate AE schemes. He discussed their relation to the charge cap, and that being outside the charge cap allowed them to implement a charging structure shaped by commercial needs rather than regulatory requirements. However, he also noted that high charges would be unappealing to members as they erode more of the pot value than the original scheme would. The second advantage he noted was that the pot size is larger, no pot starts at £0, meaning they are more profitable immediately to the provider than low value schemes.

Tim concluded his presentation by summarising the key points. He then handed back to the Chair.

Response to the findings

Josephine then handed over to **Philip Brown, Director of Policy and External Affairs, B&CE** to respond to the findings.

Philip thanked Tim and the PPI for the report. He started by commenting on the consumer perspective of charges. He noted that, for many, it is only when people take out their money that they will know the impact of a bad deal. He discussed the presentation of charges to consumers, highlighting that percentages are not very intuitive or engaging and that charges presented as simple pounds and pence would be more helpful.

Philip also discussed the need to be able to balance the charges and returns across different types of providers in order to have a meaningful comparison of charges. He then discussed consolidation of pension pots, noting that it is important for consumers to understand the difference when they are considering consolidating their pension pots.

He spoke about the regulatory focus, agreeing that the Pension Regulator and Financial Conduct Authority focus on value for money. He also went on to say that contributions adequacy is another equally important factor as charges and value for money, which needs addressing.

He finished by saying that B&CE believe that there should be a way of comparing pensions across all DC types that is meaningful to the member. The member needs to be able to make informed decisions and thanked the PPI for a report that brings out the things to consider in that regard.

Philip then handed back to the Chair.

Josephine then announced that the remainder of the meeting would be conducted under the Chatham House Rule, such that from this point on comments could not be attributed to particular speakers. She invited **Des Healy, Department for Work and Pensions** to make his response to the issues raised in the report, his specific comments fall under the Chatham House Rule.

Discussion

Josephine then introduced the question and answer session of the event. Attendees were invited to put questions to Tim, Philip and Des. Topics discussed in the Q&A session included amongst others:

- Whether there is an uneven playing field between schemes investing in capped rather than uncapped charges, and what can be done to ensure savers are not put into a worse position when moving to an uncapped scheme.
- There was discussion on the cross-subsidies that occur under different charging structures and how larger funds which often subsidise the administration costs of smaller funds may be attracted to schemes which offer them preferential rates, in turn causing an imbalance in the ceding scheme which may struggle to meet its costs with only smaller pots.
- There was discussion on the transparency of charges and how to make them more understandable to consumers. There were suggestions that percentages are difficult for consumers to correctly understand, that perhaps a pounds and pence approach is more understandable, with appropriate caveats on what may happen with changes in the pot size.
- There was discussion on how league tables might change the focus, would they be helpful or unhelpful.
- There was a question on whether it is useful to project the erosion of pots due to charges. This led to discussion on giving members appropriate expectations.

Closing Remarks

Josephine Cumbo then invited the panellists to make closing remarks. Following these remarks, Josephine thanked the attendees and closed the event.

A Pensions Policy Institute report

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