PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

PERMITTED CHARGES WITHIN DEFINED CONTRIBUTION PENSION SCHEMES

JULY 2021

ABOUT THE PLSA

We're the Pensions and Lifetime Savings Association; we bring together the pensions industry and other parties to raise standards, share best practice, and support our members. We represent over 1,300 pension schemes with 20 million members and £1 trillion in assets, across master trusts and defined benefit, defined contribution, and local government schemes. Our members also include some 400 businesses which provide essential services and advice to UK pensions providers.

Our mission is to help everyone to achieve a better income in retirement. We work to get more people and money into retirement savings, to get more value out of those savings, and to build the confidence and understanding of savers.

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EXECUTIVE SUMMARY

- We welcome the opportunity to respond to this consultation and support the de minimis approach, but have significant reservations about universal charging structures for all default arrangements and caution against breaking the employer link, which will not always be in the best interest of members.

We are supportive of a de minimis set at £100, and agree with the proposal of applying the de minimis to both active and deferred pots. We do not foresee issues applying it to multiple pots held within the same scheme, where multiple pots are identifiable as being held by a single beneficiary.

- We are supportive of the policy intent to prevent savers pots charging down to zero, however, focusing on restricting fee structures does not address the causes, only one of the symptoms, of the proliferation of small pots. It is worth noting that any fee structure will erode small pots over time, and restricting certain charging structures cannot address this inevitable outcome.
- We would urge that the Government review its decision to apply the General Levy to deferred small pots in light of the proposed intervention on permitted charges, particularly to those deferred pots below the de minimis. It is inconsistent for Government to levy charges on members whilst on the other hand also preventing them being charged.
- The de minimis may inhibit consolidation of multiple deferred small pots, as schemes may be unwilling to move a small pot below the de minimis to a pot where they will start to be charged a flat fee above the de minimis. In the short term, the de minimis may help with the stock of small pots from being eroded to zero, however, it will not do anything to prevent the flow or creation of small pots.
- There are a number of consequences for schemes where the de minimis applies. These result mainly from increasing the administrative burden, where providers must make system changes, and the requirement to communicate the change to members. There may also be implications for scheme charges in order to recoup the lost income - leading to other members having to cross-subsidise small pot members.

We do not think the Government should move to a universal charging structure within the default arrangement.

- Reforming the system to a universal charging structure for larger pots is a disproportionate approach to resolve the issue disclosure of price comparability. There could be significant impacts on the sustainability and degree to which new, innovative providers enter the market and so other steps should be taken to improve comparability before overhauling the way AE providers charge.
- The consultation asks about the ease of comparing costs and charges in the current system and we agree that it is important that members appreciate their costs and charges. However, it is arguably more important that employers understand the cost and charges, as they are choosing

the scheme for their employees, so that they take the best choices for their employees and that schemes deliver better outcomes. Both employers and providers are well positioned to do this. For example, trustees already have duties to act in the best interest of members, including on value for money, and must disclose their approach to such matters in the Chair's Statement.

- It can be difficult for members to compare current cost and charge structures. Other options to improve comparability of costs and charges may be preferable instead of mandating a universal charging structure. For example, available evidence shows that percentages are not easily comprehensible to large parts of the population as financial literacy and numeracy skills are unfortunately on average low, whereas they are better able to understand and compare 'pounds and pence' figures. Showing charges in 'pounds and pence' need not require changes to any underlying charging structure to enable comparability, and is already required in other areas of pensions such as the drawdown market.
- There are risks for members if they place too much prominence on costs and charges in isolation of other factors. Evidence[1] has found that low charges and costs do not necessarily guarantee good retirement outcomes for members. It may also reinforce existing market forces for providers to compete on price, which can have implications for their investment strategies and their ability to include illiquid investments within the default. If reforms are undertaken to improve comparability of costs and charges they should be carefully thought through.
- There are significant wider implications of moving to a universal charging structure. This would be a major overhaul of the market and disproportionate to the stated aim to facilitate better comparability of cost and charges. It is important for the industry to understand the Government's long-term strategy for the AE market as a whole and what the intended aims are.

Breaking the employer link with pensions endangers adequacy and so should be protected as one of the primary factors in defending members' best interest.

- The consultation suggests that members could choose to direct employer pension contributions. This is not currently how workplace pensions operate in the UK. Before taking decisions on such far-ranging and complex issues, we urge the Government to undertake an in-depth evidence gathering exercise supported by careful and robust analysis.
- We believe that the employer link should be protected to ensure continuing employer engagement in pensions and their employees' retirement provision. Anything that has a potentially detrimental impact on employer contributions should be discounted on the basis that this is one of the single biggest determinants of pensions adequacy. Fewer than one in ten people[2] are currently likely to achieve a comfortable income in retirement.

[1] https://www.pensionspolicyinstitute.org.uk/sponsor-research/research-reports/2019/2019-09-11-pension-charging-structures-and-beyond-an-outcomes-focused-analysis/

[2] https://www.pensionspolicyinstitute.org.uk/media/3843/20210609-adequate-retirement-income-final.pdf

CONSULTATION QUESTIONS

The PLSA conducted a survey with its membership across DC and master trusts[3]. The results are reflected in our responses below.

(1) DO YOU AGREE WITH OUR PROPOSAL THAT THE DE MINIMIS SHOULD APPLY TO ALL ACTIVE AND DEFERRED POTS? IF NOT PLEASE OUTLINE WHY.

1. We agree with the proposal to apply a de minimis to both active and deferred pots.
2. We believe there should be equal treatment between active and deferred pots and this should not create any administrative complexity.

(2) DO YOU ENVISAGE ANY CHALLENGES FOR MEMBERS AND PROVIDERS IF THE DE MINIMIS IS APPLIED TO MULTIPLE POTS WITHIN THE SAME SCHEME?

3. We do not foresee any challenges for members and providers if the de minimis is applied to multiple pots within the same scheme, where they are identifiable.
4. However, some providers may struggle to match multiple pots and ensure correct matches[4]. This issue is being considered as part of the Cross Industry Small Pots Coordination Group[5] and through dashboards work.
5. Many schemes operate on a one pot per member basis. Additionally, last year the previous DWP-chaired small pots working group[6] recommended that providers consolidate pots where they are holding multiple pots within charge-capped default funds for the same deferred members.
6. We believe evidence is needed to understand the impact of a de minimis on a member and their resulting behaviour when set at £100.

(3) WOULD PROPOSED IMPLEMENTATION IN APRIL 2022 CREATE ANY BUSINESS OR OPERATIONAL CHALLENGES?

7. Some of the larger master trusts have already, in effect, implemented the £100 de minimis. However, as with any significant intervention, especially one that effects charging and therefore the funding of schemes' activities, we believe that for some schemes the timeframe will not be achievable with less than 12 months' notice.
8. We undertook a survey of our membership and, although most respondents believe it will be feasible to implement the de minimis by April 2022 (70%); a third feel it will be unfeasible due to the system changes that will be required (30%). Making system changes takes time, is costly and can put additional pressure on schemes. Scheme and administrators are facing numerous pressures on their time with respect to a number of

[3] The survey was conducted between the 28 June and 6 July 2021. 11 AE master trusts and DC schemes responded.
[4] https://www.plsa.co.uk/Policy-and-Research/Thought-Leadership-Library/The-Idea-Series-Small-Pots-Big-Solutions
[5] https://www.plsa.co.uk/Policy-and-Research/Defined-Contribution/Small-Pots-Cross-Industry-Co-ordination-Group
[6] https://www.gov.uk/government/publications/small-pension-pots-working-group

government legislative changes, for example, the consideration and implementation of pension scams 'red flags' TCFD, changes to the normal minimum pensions age, the simpler annual statements, GMP equalisation (for those with DB schemes as well) and so on.

(4) DOES THE DRAFT OCCUPATIONAL PENSION SCHEMES (CHARGES AND GOVERNANCE) (AMENDMENT) REGULATIONS 2021 ACHIEVE THE POLICY INTENT FOR IMPLEMENTING THE DE MINIMIS?

9. We believe the draft regulations achieve the policy intent for implementing the de minimis. However, there could be additional clarity on when the size of pot should be measured in the regulations, for example, should the pot be assessed monthly or as charges are due to be collected. There could also be greater flexibility to facilitate more mechanisms and approaches to 'make right' those pots that are subject to the de minimis.
10. Most survey respondents support the de minimis (72%) and we welcome the policy intent to prevent savers pots charging down to zero. However, focusing on restricting fee structures does not address the causes, only one of the symptoms, of the proliferation of small pots. It is worth noting that any fee structure will erode small pots over time, and restricting certain charging structures cannot address this inevitable outcome. We have previously advocated that a better way of protecting very small pots may be to facilitate refunds in certain circumstances.
11. In order to better address the issue, we believe solutions are needed to target both the creation and proliferation of small pots. This work is currently ongoing through a cross-industry co-ordination group, jointly convened by the PLSA and the ABI. We would ask that government remain involved in coming up with further solutions.

(5) WHAT ARE THE FULL FINANCIAL COSTS OF ADOPTING THE DE MINIMIS FOR YOUR BUSINESS? PLEASE OUTLINE WHICH COSTS ARE ONE-OFF OR ONGOING. PLEASE OUTLINE HOW MANY POTS WILL BE AFFECTED WITHIN YOUR BUSINESS AND THE TYPES OF MEMBERS WHO OWN THESE POTS BELOW £100?

12. If a flat charge is outlawed below a de minimis level, there may be implications for schemes charges in order to recoup the lost income. It is worth noting that charges on small pots are predominantly to cover the cost of administering them; and this cost will need to be absorbed or redistributed across other pots. This might be, for example, through increasing the flat charge above the level of the de minimis; meaning that other members will have to cross-subsidise small pot members.
13. We would urge that the Government review its decision to apply the General Levy to deferred small pots in light of the proposed intervention on permitted charges, particularly to those deferred pots below the de minimis. It is inconsistent for Government to levy charges on members whilst also preventing them being charges on the other hand.

(6) WHAT ARE THE NON-FINANCIAL OR INDIRECT IMPACTS TO BUSINESSES AND MEMBERS? PLEASE OUTLINE HOW MANY POTS WILL BE AFFECTED WITHIN YOUR BUSINESS AND THE TYPES OF MEMBERS WHO OWN THESE POTS?

14. There are a number of consequences for schemes where the de minimis applies. The main impacts are those that result from increasing the administrative burden, in terms of having to make changes to providers systems, and the requirement to communicate the change to members. For a minority it will also have an implication for their investments, and on their charging model. For example, the whole charging structure of the provider may need to be evaluated to ensure financial sustainability and this could result in higher charges for other members.
15. We cannot address this question from the perspective of the number of specific pots affected within specific businesses, but have encouraged PLSA members to share this information with you directly.

(7) IN INTRODUCING A DE MINIMIS THE POLICY OBJECTIVE IS NOT INTENDED TO INHIBIT SCHEME CONSOLIDATION OF MULTIPLE DEFERRED SMALL POTS. COULD YOU TELL US IF YOU THINK THERE WOULD BE ANY IMPACT?

16. We do not believe the de minimis will impact non-automatic pot consolidation, however, the de minimis does complicate the automatic consolidation of small pots and could limit the success of any future automatic consolidation model. It could prevent the consolidation of any pot below the de minimis, if when combined the total value is above £100. There will likely need to be additional checks in a small pot consolidation process to insure that a consolidated pot was significantly over the de minimis, to make sure that a member is not worse off from consolidation. This could be an onerous task.
17. Removing the flat fee element for small pots addresses some, but not the wider issues or causes of small pots. As we have stated previously, the small pots issues should be looked at holistically. The de minimis will help to protect pots being eroded to zero but does not help to resolve either the ‘stock’ or ‘flow’ of small pots. In the short term, the de minimis may help with the stock of small pots from being eroded to zero, however, it will not do anything to prevent the flow or creation of small pots.
18. We believe different solutions will be needed to resolve the stock and flow of small pots:
    - a solution designed to operate in the short-term and deal with the stock of small pots (e.g. **consolidating returners, member exchange**)
    - a solution designed to resolve the whole issue in the longer-term and the flow of small pots (e.g. a **default consolidator**, **Pot Follows Member**, **Pensions Dashboard** as an engagement tool – in conjunction with other options).
19. We also believe that any solution to the small pots issue should incorporate the following objectives:

- There should be no material detriment to the saver from being (automatically) transferred between AE DC schemes (including consideration of costs and charges).

- Transfers should be efficient for schemes (e.g. automated or semi-automated) and simple and quick for scheme members.
- Transfers should not solely rely on active decisions by savers to take place.
- The proliferation of small pots should be stopped so that administration and other costs do not rise.
- Competition issues must be managed appropriately.

20. In order to support the small pots work and ensure the de minimis is at a suitable level, we believe it should be reviewed on a three-yearly basis.

(8) DO YOU THINK THAT MEMBERS (IN PARTICULAR AE) HAVE AN UNDERSTANDING OF YOUR SCHEME COSTS AND CHARGES? IF SO, WHAT EVIDENCE DO YOU HAVE TO SUPPORT THIS?

21. Costs and charges are an important component of value for money but they are not the only factor that should be taken into consideration. Members should understand costs and charges in the context of the overall outcome that their employer and scheme is trying to deliver them.
22. Costs and charges are capped to protect members. Within AE defaults, costs and charges are capped at 0.75% of a member's funds under management and many AE providers charge below this level. Three different charging structures are currently permitted within the charge cap; a single percentage charge of the pot value, taken at the end of each year; a combination of a percentage charged on each new contribution made, plus an annual management charge; and a combination of a monthly or annual flat fee plus an annual management charge.
23. Average PLSA member charges were previously found to be 0.46% and in larger schemes it can be considerably below this. Employers also select solutions to protect members' interests and achieve the best outcomes possible for them.
24. It is important that members are aware of their costs and charges. The majority (60%) of our survey respondents believe that it is important for members to understand their costs and charges; however, our survey also found that most providers believe that members do not understand costs and charges (80%). Previous research from Ignition House for the simplified annual statement[7] also found that members were unaware that they paid charges and were unsure what was included in the charge. The FCA has found similar evidence that members are unsure of charges (see Q9).
25. However, it is arguably more important that employers understand the cost and charges rather than members, as they are the ones choosing the scheme; so that they take the best choices for their employees and that schemes deliver better outcomes. Both employers and providers are well positioned to do this. Trustees also have significant duties to consider value for money, safeguard scheme members and explain their approach, for example as part of the Chair's Statement. The positive effects of this on member outcomes also act to

[7] Ignition House, Simpler Annual Statement: The Member perspective, August 2018

ensure that members outcomes are good regardless of their degree of comprehension or engagement.

26. We do not have any evidence to suggest that employers or their advisors are ill-equipped to assess relevant factors for scheme selection, including costs and charges, and think it important that the Government addresses this evidential gap against any projected improvement in decision making by individual members. Employers and trustees do argue for value for money and lower charges when selecting a pension scheme. This is evident in the fact that many larger master trusts charge well below the charge cap due to competition and pressure from employers and trustees. Cost and charges may be more of an issue outside of trust-based schemes where similar controls and competition pressures do not exist.
27. Conversely, there are significant amounts of evidence showing that members do not make optimal decisions and have low financial literacy, for example, at decumulation many members move to a cash fund, despite that not being in their best interests.

(9) DOES THE CURRENT SYSTEM IMPEDE MEMBERS FROM CARRYING OUT A COMPARISON OF COSTS AND CHARGES BETWEEN DIFFERENT SCHEMES? IF SO SHOULD THE SYSTEM BE REFORMED TO ALLOW FOR SIMPLE PRICE COMPARISON OF COSTS AND CHARGES?

28. There are lots of considerations that need to be taken into account before going ahead with a reform of the pension system.
29. Half of survey respondents believed that it is difficult to compare current cost and charge structures. As there is no obligation to disclose the difference between administration and investment costs (i.e. what the provider pays to external fund managers) a mix of reporting could contribute to the difficulty in comparing costs and charges. Transparency and comparability is key for the success of schemes and good member outcomes.
30. However, reforming the system to a universal charging structure may be too drastic a move to resolve this issue. There could be significant impacts on the sustainability and degree to which new, innovative providers enter the market and so other steps could be taken to improve comparability before overhauling the way AE providers charge.
31. There is also currently no evidence to show that having a single charging structure to improve comparison of schemes costs and charges would encourage people to make active decisions. Charges are also not the sole determinant of outcomes and, given the choice, members may choose to pay higher charges, if that increased the likelihood of having a greater pension income in retirement.
32. The Call for Evidence begins to describe a system that is not currently in place within the UK automatic enrolment market; one of full and complete consumer choice decoupled from employer choice. It is for good reason that the system is not designed in this way in the UK. In the UK, employers, not employees choose the workplace scheme. It is inappropriate to have a system based solely on employee choice for a number of reasons, for example, members are not well equipped to make complex choices (on investments, de-risking, and so on). The Pensions Commission also found that there are behavioural barriers to people

making rational long-term savings decisions without encouragement and advice. The Commission felt that automatic enrolment by employers was necessary, as behavioural barriers could not be overcome by better information, better regulation of the financial services industry, encouragement to good practice, and consumer education[8].

33. Members who are very engaged and financially literate, or are able to absorb higher risk are currently able to direct their saving in whichever way they would like in the retail pensions market, accepting the associated higher degree of complexity and often much higher cost.
34. The PLSA currently sit on Members' Costs and Charges Initiative Steering Group, run by Ruston Smith. This group is considering further research on how to present costs and charges to members in a clear way. The research will help to inform how people understand and engage with costs and charges information and the responses it may drive.
35. If cost comparison between schemes were made easier, this may not lead to consumers taking action. FCA research[9] with consumers making active fund selections in retail products found that 77% of respondents looked at charges when they first made their investment, however, under half of respondents reported paying any fund charges on recent investment. Additionally, higher fees did not necessarily deter investors from selecting these funds, if the fees could be justified by other factors.
36. And although not directly applicable, research from the FCA on non-workplace pensions found that product fees were not a specific factor driving selection. Other factors, such as, brand, flexibility, security and fund selection, were considered to be more important.[10]
37. Again, as stated at Q8, it is more important that employers have transparency on costs as they are choosing the most suitable pension for their employees.

(10) DO YOU AGREE THAT THE GOVERNMENT SHOULD MOVE TO A UNIVERSAL CHARGING STRUCTURE WITHIN THE DEFAULT FUND ARRANGEMENT? IF SO HOW BEST COULD THE GOVERNMENT IMPLEMENT THIS CHANGE IN ORDER TO MANAGE THE IMPACT ON THE INDUSTRY AND MEMBERS?

38. We do not think the Government should move to a universal charging structure within the default arrangement.
39. Within the default arrangement, some providers offer different charges to different employers and charges can vary depending on the size of pot i.e. those with higher pots have lower charges, as pot size does not directly affect the cost of administration, when bundled into the charge. We would like clarity on whether different single annual management charges would be allowed within a scheme under a universal charging structure to allow for tiered charging
40. There are a number of benefits to allowing multiple different charging structures. From our survey, most believe the current charging structure allows schemes to have appropriate charging to ensure a sustainable structure (73%). A third also believe it allows employers to

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[8] https://webarchive.nationalarchives.gov.uk/+/http:/www.dwp.gov.uk/publications/dwp/2005/pensionscommreport/main-report.pdf

[9] https://www.fca.org.uk/publication/market-studies/ms15-2-2-annex-3.pdf

[10] https://www.fca.org.uk/publication/research/non-workplace-pensions-consumer-research.pdf

pick a scheme which best suits the needs of its employees (36%) and allows flexibility to employers (36%).

41. Moving to a universal charging structure could limit the ability of new entrants into the market. Savers benefit from a vibrant, healthy AE market, where competition is supported. It also makes it harder to service the SME market and therefore endangers the AE policy of providing pensions for everyone.
42. Different master trusts take different approaches to accepting employers. For example, some master trusts determine whether to accept the employer based on some predetermined factors such as certain ‘target’ sectors of focus, existing partnerships relationships with other providers, on risk appetite, the degree to which the new members will complement their current membership and so on. Other master trusts will accept all employers into the scheme, no matter of their circumstance. However, the latter are at least in part able to do this by having a tiered or combination charge rather than a single charge. If the combination charge were to be removed those master trusts may not be able to facilitate schemes for the wider range of employers that they can currently and therefore choice for employers will be reduced; with NEST likely remaining the only option for them.
43. Single annual management charges are not necessarily the best fee structure for members. Previous PPI research[11] has found that combination charges generally provide better outcomes over time than an AMC-only approach. It also found that a median earning male in an AMC only scheme could be paying around £250 per annum more than a similar individual in a combination charge scheme after 40 years of contributions.
44. The consultation highlights that it would like to encourage members to make an active decision to move out of the default, where it is not suited to the member, and considers how members can better compare products. If that is the main policy intent then the proposal of moving to a single charging structure for default funds will not help with comparability of charges across other funds, as they are still able to apply combination charges, therefore this may not encourage movement out of the default. Furthermore, it is not necessarily beneficial to encourage savers to move out of a well-designed default, especially if they are making non-advised decisions based solely on charging information. PLSA members have evidence to suggest that savers do not always have better outcomes if they make an active choice.
45. There are significant wider implications of moving to a universal charging structure, which need to be fully considered. This would be a significant overhaul of the market for the purpose of allowing comparability of cost and charges. It is important to understand the wider strategy for the AE market as a whole and what the intended aims are. AE has been a huge success, mainly in part through the use of inertia; with over 10 million savers now automatically enrolled into a workplace pension.[12] Any changes should therefore be comprehensively thought through to ensure this success is not undermined.

[11] https://www.pensionspolicyinstitute.org.uk/media/3263/20190911-pension-charging-structures-and-beyond.pdf

(11) WHAT ARE THE BENEFITS OF STANDARDISATION FOR OTHER GOVERNMENT INITIATIVES SUCH AS SIMPLER STATEMENTS AND THE PENSIONS DASHBOARD?

46. It would be better to prioritise certain initiatives coming into force, such as Dashboards and Simpler Annual Statements, evaluate their impact and then look at other measures (such as a single charging structure) if found not to be successful.
    i. Current research for the simpler annual statement should provide further evidence on how members understand cost and charges.
    ii. We do not believe costs and charges should be included on initial Dashboards. However, the Dashboard will help to direct members to Providers where they will be able to find out more information.

(12) ARE THERE OTHER WAYS, BESIDES CHANGING THE CHARGING STRUCTURE, THAT COULD MAKE A SIGNIFICANT DIFFERENCE TO MEMBER COMPREHENSION OF CHARGES AND ENCOURAGE IMPROVED MEMBER ENGAGEMENT?

47. In our survey, half of respondents believe that disclosing charges in pounds and pence equivalent would make it easier to compare cost and charge structures (50%). Available evidence shows that percentages are not easily comprehensible to large parts of the population, compared to pounds and pence figures. The FCA Financial Lives Survey[13] found that 46% of UK adults have low or moderate confidence working with numbers in everyday life and a National Numeracy[14] report found that fewer than one in four working adults are functionally numerate. Percentage comparisons may also lead to overly simplistic comparisons that are dangerous to the member.
48. Showing charges in pounds and pence figures also means that the underlying charging structures do not all need to be the same to allow for comparability, as is currently the case in the drawdown market. This allows for better comparability. The FCA[15] have taken steps to increase transparency of charges for members in drawdown by making rules requiring providers to include charges in pounds and pence across relevant disclosures.
49. Prohibiting certain charging structures in order to improve comparability and understanding costs and charges may also be focusing on the incorrect policy lever. Enhancing disclosure requirements, rather than pricing control, may be a better approach to ensuring members get better information and understanding. Rethinking cost and charges disclosure in general might be a more helpful first step and work is already ongoing to find out how savers understand charges, compare and act as a result of the information.

[13] https://www.fca.org.uk/publication/research/financial-lives-survey-2020.pdf
[14] https://www.nationalnumeracy.org.uk/sites/default/files/documents/Building_a_numerate_nation/building_a_numerate_nation_report.pdf
[15] https://www.fca.org.uk/publication/market-studies/ms16-1-3.pdf

(13) WHAT OTHER RISKS EXIST FOR MEMBERS WHO MAY CHOOSE TO MAKE DECISIONS ON WHICH OCCUPATIONAL PENSION SCHEME THEY SHOULD SAVE INTO, BASED PURELY ON THE LEVEL OF THE CHARGES THEY MAY PAY?

50. Members do not currently chose their own occupational pension schemes. The market would need to evolve significantly in order for this to work, for example, there is currently poor member understanding of investment, and general low confidence in financial literacy.
51. Regardless, there are risks for putting too much prominence on costs and charges in isolation of other factors. A PPI report[16] found that low charges and costs do not necessarily guarantee good retirement outcomes for members. Therefore, placing too much emphasis out of context of other factors may lead to worse outcomes for members. Full Value for Money (VfM) assessments are crucial in order to understand the true value that a scheme represent. A standardised framework for VfM reporting would also allow for better comparability of schemes.
52. Overdue focus on costs and charges may also reinforce existing market forces for providers to compete on price, which can have implications for their investment strategies and their ability to include illiquid investments within the default.
53. Although not directly applicable, it can be useful to look at evidence from the FCA's Asset Management Market study[17]. This found that some investors chose to invest in funds with higher charges because they expect to achieve higher future returns. However, academic and Morningstar research from the US suggests that higher charging funds are not on average generating higher performance, compared to cheaper funds in the same investment category. Therefore, making decisions based solely on pricing could lead to sub-optimal outcomes for members and not necessarily lower charges.
54. Further research on member behaviour and what information they would find helpful is needed.

(14) WILL THIS PROPOSAL TO MOVE TO A SINGLE CHARGING STRUCTURE CHANGE THE WAY EMPLOYERS SELECT THE PENSION SCHEME THEY USE FOR AUTOMATIC ENROLMENT AND WOULD AN EMPLOYER CONTINUE TO PAY THEIR 3% MINIMUM CONTRIBUTION IF THE EMPLOYEE DECIDES TO MOVE THEIR PENSION SAVINGS TO A DIFFERENT PROVIDER?

55. We believe that the employer link should be protected to ensure continuing employer engagement in pensions and their employees' retirement provision. In fact, the Pension Commission highlighted that a new pensions settlement should 'maintain employer involvement in good quality pension provision'[18]. We believe that asking employers to pay into a different provider could undermine the critical employer link to pension provision. Anything that has a potentially detrimental impact on employer contributions should be

[16] https://www.pensionspolicyinstitute.org.uk/sponsor-research/research-reports/2019/2019-09-11-pension-charging-structures-and-beyond-an-outcomes-focused-analysis/
[17] https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf
[18] https://webarchive.nationalarchives.gov.uk/+/http:/www.dwp.gov.uk/publications/dwp/2005/pensionscommreport/main-report.pdf

discounted out of hand on the basis that this is one of the single biggest determinants of pensions adequacy.

56. It is not very common for employers to make contributions into a scheme chosen by the employee. However, this can sometimes be more prevalent with those on higher salaries, or those that start a job at the end of their career and already have a larger pension pot in place. This arrangement is usually agreed at the start of employment. However, due to administration difficulties outlined below, issues and miss-payments can occur (at least initially).
57. Some of the elements proposed, where the employee chooses a provider and directs the contributions, are reminiscent of a Lifetime Provider model. This was previously discounted by the DWP Chaired Small Pots working group for a number of reasons:[19]
    i. Allowing employees to direct where their pension contributions are sent would be would be a fundamental change in how workplace pensions operate and could result in losing the benefit of inertia, which AE is built on.
    ii. It would place an increased administration burden on employers and payroll as they would need to deal with paying contributions into multiple schemes.
    iii. The payroll community feedback, represented in the Working Group process, highlighted that this would need considerable new investment costs and a multi-year implementation.
    iv. It would break the connection with the employer, which could weaken their engagement with the workforce on their retirement provision. Pension values are also increasingly shown on Total Reward Statements, which would be impossible with multiple providers for each employer.
    v. Employers may be discouraged from going beyond the minimum.
    vi. There could also be issues for schemes in ensuring contributions are paid regularly, monitoring AE compliance and following up late payments, where they do not have a stronger link with the employer.

(15) DO EMPLOYERS WHO ARE CHOOSING A PENSION SCHEME ROUTINELY NEGOTIATE THE LEVEL OF THEIR OWN CHARGES WITH THE PROVIDER, AND IF SO WHAT IMPACT MAY THIS HAVE ON THE EMPLOYEE'S CONTRIBUTIONS?

58. Some Providers do offer the ability for employers to negotiate. However, those master trusts catering to the mass AE market tend to have a set rate or fee for all employers.
59. Employers may benefit from additional help in engaging with external providers. For example, when choosing a scheme employers need to take into account several factors, including, the composition of workforce, how tax relief is administered, the offering to members.

[19] https://www.gov.uk/government/publications/small-pension-pots-working-group

DISCLAIMER

Material provided in this publication is meant as general information on matters of interest. This publication is not meant to give accounting, financial, consulting, investment, legal, or any other professional advice.

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