NAPF SUBMISSION TO THE PERSONAL ACCOUNTS DELIVERY AUTHORITY CONSULTATION ON CHARGING STRUCTURE

SECTION 1 - INTRODUCTION

1. The National Association of Pension Funds welcomes the opportunity to respond to the consultation document *Building Personal Account: Choosing a charging structure* issued by the Personal Accounts Delivery Authority (PADA) on 29 January 2008. The NAPF supports the 2012 reforms and the creation of Personal accounts as a means of providing a workplace pension to those who currently do not have access to one.

2. This paper sets out the NAPF's overall views on PADA's charging proposals as well as a response to the thirteen specific questions posed by PADA in the consultation document.

About the NAPF

3. The NAPF is the leading voice of workplace pensions in the UK. Our 1300 members provide pensions on behalf of more than 15 million people and have combined assets of around £800 billion.

SECTION 2 – NAPF GENERAL COMMENTS

4. PADA has made it clear within the consultation document that it is initially consulting solely on the charging structure itself rather than the specific level of charges for the Personal Accounts scheme. The NAPF indicated in their 2007 White Paper response *Personal Accounts - Hitting the target?* that an aspiration for low scheme charges, while entirely valid, should not become the sole objective and compromise quality in terms of scheme design, the investment default fund or member communications. For example, in the case of the charge for investment management, the net charge (after returns) is more relevant than the gross charge.

5. PADA has proposed four charging options within its consultation document which are listed below :
   - Annual Management Charge (AMC)
   - Contribution Charge
   - Joining Fee
   - Contribution Charge with an AMC

   Having evaluated the four options (see analysis in Annex A) the NAPF recommends the contribution charge with an AMC as the best option.

6. The NAPF believes that this combined charge is the best of the four options. It provides both the benefits of an AMC, low charges in the early years so encouraging members to stay opted in, and the advantages of a contribution charge, (i.e it provides a steady income stream and avoids eroding the pension pot when the account is dormant).

7. The combined charge also offers some cross subsidy between active and dormant account holders and can also help to mitigate risk as the combined charge could balance market risk (i.e. poor investment returns) against financial risk (i.e. a large number of dormant accounts). It also avoids some of the problems involved with an AMC i.e. substantial cost falls on the fund in later years.

8. The NAPF feels however that it is difficult to have a final view on the most appropriate charging structure for Personal Accounts without knowing more about the proposed business model and underlying cost assumptions, in particular the forecast revenues and the payback period for the start up loans.

9. PADA has indicated that the Personal Accounts scheme will be reviewed after five years in 2017/18. The NAPF would support a review and note that by 2017 and beyond any changes to the Personal Accounts scheme would become the sole responsibility of the trustees of the scheme who will eventually supersede PADA.

10. Following this initial review and provided member take up of Personal Accounts has been in line with revenue forecasts either on target, or better, the NAPF would expect to see scheme charges falling as the initial start up costs, plus interest, begin to be repaid.

SECTION 3 – NAPF COMMENTS TO SPECIFIC QUESTIONS

11. This section provides the NAPF's responses to the specific questions raised chapter by chapter by PADA in the consultation document.

Charging and the authority's principles

Question 1- How should the principles of the Personal Accounts Delivery Authority relate to the charging structure recommendation, and in what way should the principles best be applied in this context?

12. PADA should be mindful that their principles commit them to consider the diverse nature of the target audience for Personal Accounts i.e those on low to moderate earnings who are not currently saving and who do not have access to qualifying employer schemes.

13. This would suggest that minimising cost to employees and minimising the administrative burden on employers should be a major consideration when considering the charge structure.

Charging in the Financial Services Industry

Question 2 – What are the charging structures currently used by the financial services industry, both for pensions and other financial products?

14. Current charging structures include annual management (AMC) or administration charges (% or basis points per annum) or unitisation (where a pooled fund consists of a total number of units and the charge is incorporated in the daily price of a unit).

15. In addition the results of a recent NAPF member survey suggest that a majority of defined contribution occupational pension schemes do not charge their members any fee, or only charge a reduced fee. In these cases the plan sponsor meets some or all of the costs.

Question 3 - What are the rationale for these charging structures, and which of these rationale are relevant to personal accounts?

16. The rationale behind any charging structure is that it should be 'fit for purpose' in relation to the objective concerned. The objectives of the Personal Accounts charge, in our view, are encouraging high participation, sustainability and adequate retirement outcomes.

17. The NAPF believes that this combined charge is the best of the four options. It provides both the benefits of an AMC, low charges in the early years so encouraging members to stay opted in, and the advantages of a contribution charge, (i.e it provides a steady income stream and avoids eroding the pension pot when the account is dormant).

18. The combined charge also offers some cross subsidy between active and dormant account holders and can also help to mitigate risk as the combined charge could balance market risk (i.e. poor investment returns) against financial risk (i.e. a large number of dormant accounts). It also avoids some of the problems involved with an AMC i.e. substantial cost falls on the fund in later years.

19. The NAPF believes that a combination of two charging structures, that is a hybrid of a contribution charge with an AMC with both elements in the combined package being charged at a lower rate than if applied separately, would be appropriate.

20. The hybrid charge combines the benefits of an AMC (low charges in the early years so encourages members to stay opted in) and that of a contribution charge (provides a steady income stream and avoids eroding the pension pot when the account is dormant).

21. The combined charge also offers some cross subsidy between active and dormant account holders and can also help to mitigate risk as the combined charge could balance market risk (i.e. poor investment returns) against financial risk (i.e. a large number of dormant accounts). It also avoids some of the problems involved with an AMC i.e. substantial cost falls on the fund in later years.

22. However, any combined charge would need to be as clear and simple as possible in order to overcome any member perception of being charged twice with the consequences of opt-outs from, and reduced participation in, the scheme.

Charging Structure options

Question 4 – Are there any other charging structure options that might be suitable for personal accounts that are not included in this document?

23. Unitisation as described in the answer to question 3 above. However we consider the AMC and contribution charge to be the best option.

Question 5 – Should additional charges be made for particular scheme activities?

24. Yes. The opportunity to invest in funds beyond the standard equity/bond/cash mix should carry an additional charge (e.g. a diversified growth fund).

25. However, to ensure that charges to members are kept to a minimum PADA or ultimately the scheme trustees should be robust in their fee negotiations with potential managers and service providers to ensure charges levied remain appropriate.

Question 6 – What activities could members reasonably expect to pay more for, what activities could administrators reasonably expect to charge for, and why?

26. Members who wish to undertake frequent transfers between fund options should have to pay additional charges. However, it would be reasonable to allow a limited and specified number of transfers.

27. In addition, if it is decided to provide more than a small number (for example, three or four) of fund options, it might also be appropriate to allow an additional

charge. But any additional charge should be clearly sign-posted. NAPF would recommend the Personal Accounts scheme begins with a limited number of investment funds and only considers extending the range if there is considerable member demand and to do so would satisfy the diversification requirements of the trustees' investment strategy.

28. It would also be reasonable to charge more for non-core services, such as guidance services.

29. In general, administrators should not be allowed to charge extra amounts unless services are clearly outside of the core mandate and involve considerable additional cost falling on the administrator.

Evaluation Criteria

Question 7 – Are these evaluation criteria appropriate?

30. In our view, the most important criterion of the three suggested (participation, sustainability, and outcomes) is participation.

31. We also believe that member outcomes are important but primarily in terms of achieving a low overall charge (and thereby ensuring as large a retirement pot as possible) rather than the inter-generational issues (ie. the age at which a person joins Personal Accounts) raised in the consultation document. In any case, the final outcomes between those that join when young and those that join a little older are not significantly different.

32. While it is clearly important that the Personal Accounts scheme adopts a charging structure that enables it to operate over the long term, this should not be allowed to detract from the core objectives of Personal Accounts, i.e. to achieve high participation for low to moderate earners at a low charge.

Question 8 - Which evaluation criteria do you think are most important for personal accounts, and why?

33. Of the three evaluation criteria identified by PADA participation is the most important as the long term goal of the scheme is to increase the level of saving among the target audience for Personal Accounts.

Question 9- Are we missing any criteria that might be relevant?

34. None of which we are aware.

Member Outcomes

Question 10 - How should we assess the impact of different charging structures on member outcomes, and why?

35. Any assessment should be based on the impact the charge structure has on enrolment of the target group and impact on the final pension available to each saver.

36. The impact of charging structures must be easily understood by members or they may conclude (possibly incorrectly) that their pension is being eroded by fees charged.

Participation in the Personal Accounts Scheme

Question 11 – What is your experience of the effects of different charging structures on the perceptions of consumers?

37. In the experience of NAPF members, an increasing number of plan sponsors have either begun to meet fully or reduce the administration fees payable in occupational DC plans. Consequently, we believe that a high initial charge for Personal Accounts is likely to discourage enrolment.

Question 12 – What evidence is there about how consumers' perceptions affect participation in pension schemes or other financial products?

38. There is a body of survey evidence from marketing programmes and customer satisfaction surveys among financial product providers that consumers are less likely to purchase savings products where they do not perceive a positive benefit or some doubt exists over the likely returns. This theme was explored further in a 2006 Research Report *Attitudes to Pensions* commissioned jointly by the DWP and HM Revenue and Customs.

39. The lack of clarity around charging and advice for Stakeholder Pensions following their introduction in October 2001 had a negative long term impact on the take up of those plans.

Minimising Costs

Question 13 – What evidence is there about the way in which administrative complexity or member behaviour have affected costs in existing financial products?

40. Additional administrative complexity due to having to provide more complex products tends to increase costs. This is mainly due to having to undertake manual intervention to the existing automated processes or because of additional IT requirements.

41. As mentioned in the response to Q6 above (paragraphs 21, 23-24) if member behaviour requires an increased degree of product flexibility this would probably impact on total costs.

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Annex A

Pro's and con's of different charging structures suggested by PADA

	Pros	Cons
AMC	• Small charges in early years, so unlikely to encourage opt outs • Distributive effects consistent with Government's aim that charge should take account of ability to pay • Familiarity as charge structure is comparable to that within other forms of pension provision	• Would take longer to recoup start up costs • AMC levied on total fund (pot) so reduces an element of investment returns earned overtime
Contribution Charge	• Easy for members to understand • Less incentive to opt out in early years compared to joining fee • Distributive effects consistent with Government's aim that charge should take account of ability to pay • Easier to recoup set-up costs more quickly than with an AMC	• Dormant (non-contributory) account holders do not pay anything for account maintenance so receive cross subsidy from current contributors which is inequitable • More incentive to opt out in early years than with AMC
Joining Fee	• Easier to recoup set up costs than in the other proposed models • 'One off' payment so no further reduction in members' total fund value from future charges	• If a flat fee (e.g £100 p.a) then no account is being taken of the members ability to pay • If based on X%p.a. of contributions would the fee be the equivalent of the initial two months contributions and when would it be collected? • Larger initial fee is a greater incentive to opt out in early years
Contribution Charge with an AMC	• Combines the benefits of an AMC (low charge in the early years encourages members to stay opted in) and that of a contribution charge (provides a steady income stream and avoids eroding the pension	• A combined charge may be more difficult to communicate to members • Perception of members is important as size of combined charge may initially encourage opt outs

	pot when account is dormant) • A fairer balance across the generations and active and dormant account holders • Has short term and long term financial viability • Easier to recoup set-up costs with combined fee than with separate AMC and contribution charge • Helps to absorb risk of a large number of dormant accounts	