TISA

Response by TISA to: Permitted Charges within Defined Contribution Pension Schemes

Renny Biggins, Head of Retirement
renny.biggins@tisa.uk.com – 07802 324962

About TISA

The Investing and Saving Alliance (TISA) is a unique, rapidly growing membership organisation for UK financial services.

Our ambition is to improve the financial wellbeing of all UK consumers. We do this by focusing the convening the power of our broad industry membership base around the key issues to deliver practical solutions and devise innovative, evidence-based strategic proposals for government, policy makers and regulators that address major consumer issues.

TISA membership is representative of **all sectors of the financial services industry.** We have **over 200-member firms involved in the supply and distribution of savings, investment products and associated services**, including the UK's major investment managers, retail banks, online platforms, insurance companies, pension providers, distributors, building societies, wealth managers, third party administrators, Fintech businesses, financial consultants, financial advisers, industry infrastructure providers and stockbrokers.

As consumers, the financial services industry and the economy react to and recover from the effects of the pandemic, the importance of the three key pillars of work that TISA prioritises has never been more apparent:

- **Strategic policy initiatives that influence policymakers** regarding the financial wellbeing of UK consumers & thereby enhancing the environment within which the industry operates in the key areas of **consumer guidance, retirement planning, later lifetime lending, vulnerable customers, financial education, savings and investments**.
- TISA is recognised for the **expert technical support provided to members** on a range of operational and regulatory issues targeted at improving infrastructure and processes, establishing standards of good practice and the interpretation and implementation of new rules and regulations covering **MiFID II, CASS, ESG/RSI, operational resilience, Cyber Risk, SM&CR** and a range of other areas.
- **Digital transformation initiatives** that are driving ground-breaking innovation and the development of industry infrastructure for greater operational effectiveness and revenue promoting opportunity for firms. TISA has become a major industry delivery organisation for consumer focused, digital industry infrastructure initiatives – **TISAtech** (a digital marketplace that brings together financial institutions and FinTechs for greater collaboration and innovation) and **TURN** (TISA Universal Reporting Network – a digital platform providing a secure data exchange for financial services using blockchain technology) – alongside projects **Digital ID** and **Open Savings & Investment**. This reflects TISA's commitment to open standards and independent governance.

Executive Summary

TISA welcomes the opportunity to respond to the DWP consultation – Permitted Charges within Defined Contribution Pension Schemes.

We agree with the proposals relating to the de minimis, which is an important and positive change. The Small Pots joint industry/government initiative is currently progressing and given the strong overlap which will exist with pots impacted by the de minimis and those impacted by small pot consolidation, it would make sense to align the rolling out of these proposals with the agreed small pot consolidation framework. Any potential conflicts where the de minimis disincentivises small pot consolidation can also be considered by the consumer detriment workstream that forms part of the initiative.

Much work has been undertaken by government and industry in recent years focusing on consumer protection and the governance processes in place for Trustees and IGCs. In recent months, Value for Money/Members (VfM) has been at the centre of several consultations, and the more holistic approach to assessing a pension scheme's performance in relation to its membership and similar schemes has been welcomed by industry.

We are therefore somewhat surprised and disappointed to see that much of this has been discounted in the second half of the consultation and the focus is moving away from VfM and back to costs and charges in isolation. Whilst costs and charges do form part of the VfM assessment, they cannot be considered on their own and will lead to poor outcomes if they are. They are also not

As we continue to identify ways to boost consumer engagement, an understanding of costs and charges alone will not accomplish this. Engaged members understand the many positive benefits that pensions provide. It is somewhat peculiar that the consultation seeks to engage people by focusing on how much (or little) it will cost them, rather than focusing on the benefits provided.

We do have concerns with the proposal relating to a universal charging structure for the default fund. Whilst we understand the good intentions, aside from the consumer harm that this could cause through its narrow focus, it is likely to have potentially significant impacts on providers, which in turn will filter through to further impacts on the underlying consumer.

Similarly, we have strong concerns with the question inferring an employee being able to select their own AE scheme. The AE framework has been constructed with the link between scheme/employer/employee at its core. Any break in this structure fundamentally changes AE and removes much of what has made it the success it has been to date.

We would welcome the opportunity to discuss any aspects of our response with you.

Question responses

1. Do you agree with our proposal that the de minimis should apply to all active and deferred pots? If not please outline why.

We agree with this proposal.

2. Do you envisage any challenges for members and providers if the de minimis is applied to multiple pots within the same scheme?

We would ask for clarification on this proposal as there is uncertainty as to how this should work i.e. is this on an individual or collective pot size within the scheme. Example queries are below:

An individual holds 3 pension pots within a single provider scheme of £2,000, £4,000 and £50. As the collective pot exceeds £100 can a flat fee be applied to all three pots, even though one is under £100?

If the 3 pension pots held were £50, £50 and £50 totalling £150, could the flat fee be applied to all three pots, even though they are all under £100?

The above also assumes the member is invested in the provider's default fund for all pots.

3. Would proposed implementation in April 2022 create any business or operational challenges?

There is a large amount of regulatory change being implemented currently, with future proposals possibly also provisionally tabled for 2022. The proposed date will not allow the required time to enable firms to implement these changes.

It would be logical to incorporate the proposed changes into the existing ongoing government/industry initiative relating to Small Pots, which is closely linked to Pension Dashboards.

4. Does the draft Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2021 achieve the policy intent for implementing the de minimis?

There appears to be a discrepancy in the consultation content and the draft regulations.

Extract from draft regulations:

(6) Where the flat fee charge under paragraph (4)(a), if levied in its entirety, would have the effect of reducing the value of the member's rights under the scheme to less than £100, that charge may only be levied to the extent that it does not reduce the value of those rights to less than £100.

Extract from consultation:

For any pot worth £100.01 or more, and for any month where both the annual percentage charge and flat fee are payable, the percentage charge should be applied first, and then if the value of the pot is worth £100.01 or more a full or partial flat fee can be applied.

The regulations state that a flat fee cannot reduce a pot below £100, however the consultation wording states a flat fee could reduce the pot to less than £100.

Clarification is needed to confirm what the correct approach should be in this scenario. Please also see our response to Q2 which links into this aspect.

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?

TISA member firms will provide specific details in their own responses.

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?

TISA member firms will provide specific details in their own responses.

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?

This links into Q6 and the impact this could have on members. There maybe some impact and a potential barrier where a small pot consolidation results in the transferred pot being subject to higher charges when consolidated into a pot which is greater than £100.

As proposed in Q3, this sort of impact should be identified and dealt with in the industry/government Small Pots initiative, as there is a work stream looking at potential member detriment.

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?

We are not aware of any research which is specifically focused on members' understanding of costs and charges in isolation.

Research more generally links to low levels of engagement, particularly at younger ages, which can be evidenced through the success of Auto Enrolment (AE) based on the principle of inertia.

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?

The entire framework for AE is predicated on the principle of inertia, with the employer/employee/scheme link placed at its centre.

Significant work has been and continues to be focused on the responsibilities placed on IGCs and Trustees to ensure their scheme members are receiving good Value for Money (VfM). We should have confidence that providers and regulatory bodies are fulfilling these requirements. If not, there is a much more fundamental and important issue to address.

This question should therefore not be applicable to an active member of a qualifying workplace pension scheme. However, it would be relevant where deferred members consider consolidation. For this cohort, it would be appropriate for them to consider a comparison exercise.

Currently, this is not easily accomplished as providers do not have to disclose costs and charges on the annual benefit statement – this is also extended to the proposed Simpler Annual Benefit Statement. Where costs are disclosed, these are not consistent in terms of calculation or presentation.

One approach to enable a cost and charges comparison on a 'like for like' basis would be for schemes to provide an illustration based on industry standard assumptions (e.g. investment return, growth rates) with the only variable being the typical scheme costs and charges. If this were provided in pounds and pence, it would enable a simple comparison to take place.

However, we strongly emphasise that a comparison of costs and charges in isolation will not lead to good outcomes. There are a multitude of factors which need to be considered before deciding on an appropriate scheme, in the same way that an IGC or Trustee cannot simply focus on costs and charges when undertaking their annual assessments.

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?

No, we do not agree with a universal charging structure for the default fund.

The three charging structures currently permitted enable firms to structure their charges in line with their propositions and membership demographic. If all schemes were identical in terms of their membership and propositions, then this would make more sense. However, schemes vary significantly in these areas for several reasons such as competition, target market and size/financial strength. The freedom to define propositions within existing regulatory parameters is what encourages innovation, drives down costs and improves consumer experiences. These propositions have been predicated on certain financial assumptions and to change those would potentially result in sizeable impacts for all connected parties.

A move to a single charging structure will impact primarily on a scheme's profitability - to varying degrees and for some, this will be significant. For those providers facing a negative impact, this may filter through to member outcomes. Where profitability is reduced, this will restrict the ability to make further proposition enhancements and any competitive edge may be lost. Worst case scenario is the scheme can no longer meet the increasing costs of authorisation and needs to be wound up.

The introduction of a universal charging structure is essentially a step towards homogenising pension schemes. Unintended but likely effects would be:

- Default fund compositions being broadly similar in design despite different membership demographic
- Stifles innovation – reduced profitability will impact on ability to spend money on proposition enhancements
- Reduces stability of AE framework – firms may be impacted to the point of needing to wind up and consolidating to a scheme which doesn't necessarily provide the same VfM to that membership demographic. This would lead to increasing negative perceptions of the UK pensions industry
- Restricts the ability to meet Government aspirations to diversify investment into illiquid assets which tend to be more costly
- Propositions will become more standardised – profitability is central to proposition design. This in turn will encourage less engagement from employers and members as schemes will essentially be the same with a different label

- NEST would be placed with an unfair advantage as any negative impact would be underwritten by the UK taxpayer

11. What are the benefits of standardisation for other government initiatives such as simpler statements and the pensions dashboard?

We do not believe there is any benefit to the standardisation of costs.

This will have an overwhelmingly negative impact on many AE schemes, the AE framework and more generally, the competitive free market we experience today within set regulations and parameters.

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?

We do not believe there is any evidence to support that an understanding of costs and charges leads to improved member engagement. An engaged member may understand this level of detail however engagement will not generally originate from this source.

To support this, NMG 2017 IGC and workplace pension provider research showed that charges did not feature in the top 10 scheme attributes for majority of scheme members. The quality of the overall experience and the end outcome were considered more important than a headline price in isolation.

Whilst costs and charges are an important factor to consider, they are a single element in a much wider list that needs consideration. Engaged members understand the many positive benefits that pensions provide. It is somewhat peculiar that the consultation seeks to engage people by focusing on how much (or little) it will cost them, rather than focusing on the benefits provided.

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?

Employees do not choose which scheme they save into – this is an employer decision and is a fundamental principle of Auto Enrolment. Members are currently free to select their investment funds however 99% are in the scheme default. This evidences that employees do not make choices even when they are able to.

Other factors (not exhaustive) which would be included within the definition of VfM are:

Default net fund performance
ESG approach
Online proposition
Retirement options
Quality of communications
Quality of administration

A focus on costs and charges in isolation means that there is a strong likelihood a member moves to scheme which represents less VfM than others. This may become apparent over time and a form of engagement may unfortunately be triggered through negative experiences, which is an outcome we would want to avoid.

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?

We have no evidence to support answers to these questions as they have never been considered. These would completely overhaul the AE framework and the principles which have made it the success that it is today. Members are currently free to select their investment funds however 99% are in the scheme default. This evidences that employees do not make choices even when they are able to.

AE is built on the premise of inertia with the employer/employee/scheme relationship at its core. Any move away from these basic principles would undermine everything that has been achieved to date. If an AE scheme decision could in future be made available to an employee, our thoughts include:

- Much work has been placed on increasing the governance of workplace schemes. Is this being discounted and what benefit would there be in allowing an employee to choose their own over and above the governance processes in place?
- Many employers negotiate bespoke charging structures which an individual could not. There would be no economies of scale for the single employee
- Many employers send out regular communications and arrange for the scheme provider to facilitate engagement sessions and seminars – an individual who opted out of the employer scheme would not benefit from this
- The employee nominated scheme would need to be a qualifying scheme. This scheme would also potentially be administering single pots for hundreds of unconnected employers There may be no or little appetite for schemes to operate this model
- The employee would be re-enrolled into the employer scheme
- The employee would not benefit from the employer's review of the scheme on a regular basis potentially involving advisers and EBCs
- AE was built from an employer perspective for payroll. Introducing potentially multiple AE schemes for an employer to direct contributions to is logistically challenging, potentially not viable for smaller employers, and would require HMRC process changes
- For some employers, charges may become a secondary consideration. If they have a workforce of predominately low paid workers earning around £10,000 to £12,500, the main consideration would be choosing a scheme which operated RAS to remove the Net Pay Anomaly
- The increased cost and admin for an employer could be offset through a levelling down of contribution level

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?

Many of our member firms who offer bespoke pricing models are regularly contacted by employers and EBCs to discuss tailored charging solutions to suit the underlying scheme demographic.

Annex A

The AMC is referenced as 'A single percentage charge is when providers take a percentage of the pot value at the end of the year'. Please note that in most instances, these are deducted on a daily basis.