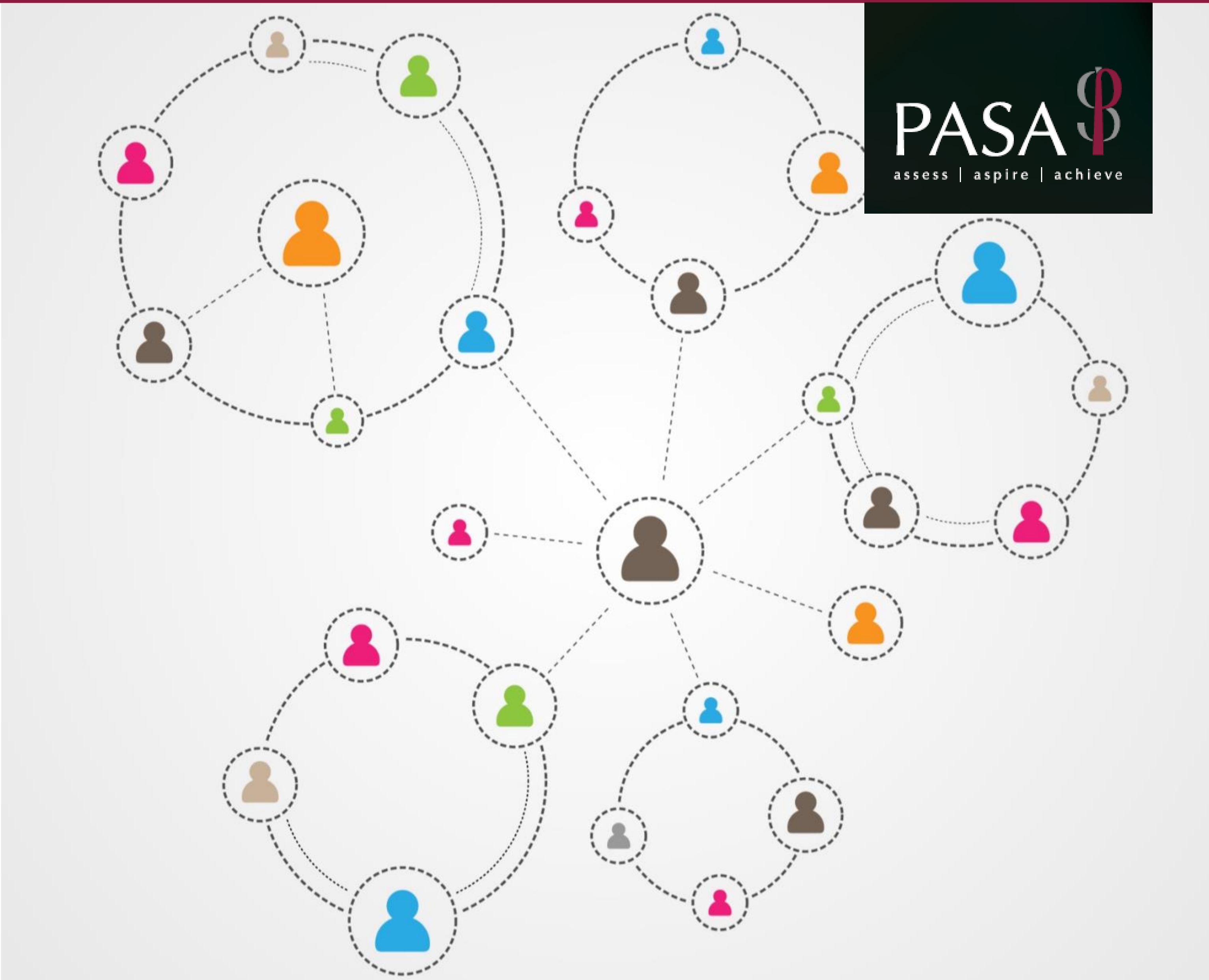

PASA
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PASA Consultation Response

DWP Consultation: Permitted charges within Defined Contribution pension schemes

July 2021

Acknowledgments

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1. Introduction – About PASA

The Pensions Administration Standards Association (PASA) was created to provide an independent infrastructure to set, develop, guide and assess administration standards.

PASA acts as a focal point and engages with the industry and government to create protocols for understanding good administration - but also appreciates there is no one size that fits all. PASA develops evidential accreditation practices which allows benchmarking across and between the industry regardless of how the administration is being delivered.

As well as raising the profile of pension administration generally, PASA focuses on three core activities.

1. Defining good standards of pensions administration relevant to all providers, whether in-house, third party or insurers
2. Publishing Guidance to support those standards
3. Being an independent accreditation body, assessing the achievement of good standards by schemes (regardless of provider)

There's no organisation providing such services across schemes, yet there's a demand for evidence of service quality from scheme trustees, sponsors, administrators, insurers, scheme members and regulators.

About PASA Accreditation

PASA Accreditation is open to all corporate members of PASA (DB, DC, trust-based and contract-based schemes).

PASA Accreditation is granted following an independent evaluation and assessment process, which includes on-site visits and the review of documentation to evidence controls, procedures, process, staff development and contractual positions with clients.

Full details on PASA can be found by visiting www.pasa-uk.com

2. Consultation questions and responses

Note: In PASAs response we focus on administrative processes and systems rather than the commercial impact this may have on schemes and providers, though this is highlighted where relevant as an important point of consideration for sponsors and providers.

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 believe the de minimis should be applied to all active and deferred pots if adopted. Whilst the introduction of the de minimis will add complexity to administration charging processes, it'll limit the pain by avoiding the double complexity and additional provider costs of differentiating between active and deferred pots.

   The commercial impact to providers of applying the de minimis to active members should be modest as one would expect pots to quickly exceed the agreed level. However, if the threshold moves materially over time this balance might be disrupted. We would therefore suggest the de minimis isn't indexed but reviewed every three years.

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

   This is a very practical issue for providers, and we must be conscious cross subsidies exist within charging structures between members with larger pots and those with smaller pots.

   Whilst the proposed charge limits would initially impact on the provider, in the longer term this will reflect on wider charges to the scheme. If a member has multiple pots within a scheme which can be linked on their administration system, then the de minimis should be applied to the sum total rather than the individual pots. If this approach is taken the member will get the protection the regulations are designed to achieve, and the wider membership won't be overburdened with the impact of cross subsidies. However, it's to be expected some schemes will be unable to link records easily on systems which will mean the pots have to be considered individually meaning the member would secure additional charge limitation benefits but the wider impact on the providers business model would be further impacted.

   At a practical level any de minimis structure needs to allow some tolerance for investment price driven movements which could see fund values move above and below the de minimis figure frequently as investment markets fluctuate. This is a feature of any flat de minimis amount rather than being specific to the proposed £100. Alternatively, it should be considered at a fixed point once a year.

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

We believe implementation in April 2022 will create some real business and operational issues as the system changes required are more complex than might be appreciated. System changes have to be specified carefully and to do this system programmers need details of full regulations at a very granular level of detail. There then needs to be time allowed for the testing of systems before they go live.

There are a number of concurrent pending regulations which might have competing implementation timeframes e.g. pension dashboards, simplified benefits statements etc, which should be taken into account in timescale planning.

The schemes and providers dealing with auto enrolment and therefore the de minimis issue are usually larger schemes where manual intervention is not practical and system solutions will be needed.

We would therefore recommend a longer implementation period is considered. This would ensure sufficient time and appropriate care can be taken in implementing other DWP and pensions regulatory initiatives, such as pensions dashboards and simpler statements.

The pensions administration industry recognises the merit of the upcoming modernising pension initiatives including dashboards, small pots, simpler statements and a statement season and is keen to make each of them successful. However, the upcoming initiatives need to be prioritised and implemented following a holistic timetable.

Consideration should be given to the impact of reduced operational revenues and the effect on the pension provider.

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

PASA doesn't have a comment on this question.

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?**

PASA Is an industry body rather than a scheme or provider so we're unable to quote specific costs. However, we would expect system changes and testing costs to be hundreds of thousands of pounds per provider or scheme in the instance that services are provided internally.

There are potential costs to investment managers and fund accounting if annual management charges need to change to reflect the impact of the de minimis on the business case of the scheme. Changes to scheme documentation, member communications, websites and member disclosure would also incur costs.

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?**

   PASA Is an industry body rather than a scheme or provider so we're unable to quote scheme specific data. However, we would expect non-financial and indirect impacts will include:

   - changes to member communications and potentially some member confusion about how charges work
   - a reduced urgency for pot follows member initiatives as the financial impact for members with small pots will be significantly reduced. Conversely, there may be more of a push from the industry for pot follows member, as small pots become even more unprofitable.
   - changes to the types of business providers will accept as auto enrolment vehicles as the economics of business will be changed. Interestingly, Nest was designed to cater for employers other schemes would not accept commercially, and it is a scheme with a mixed charging model

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?**

   The answer relates to the content of question 2. If a scheme is able within the rules to treat the sub pots from different sources as a single overall pot for de minimis purposes, then it shouldn't be inhibited. However, if each sub pot is treated separately it could prove to be a significant obstacle to schemes being able and prepared to accept small pots inflow. Overall, if structured properly it won't inhibit small pots consolidation although one might argue the rationale for doing it at a member level is depleted. If members have the ability to manage multiple pots separately (e.g. transfer one but not others) then arguably they should be administered separately, and charges applied separately.

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?**

   PASA Is an industry body rather than a scheme or provider so we're unable to quote scheme specific data. However, we believe members with small pots are by and large unengaged with their pension benefits and will have limited understanding of charging. The evidence of lost posts/benefits both pre and post auto enrolment is strong evidence of this, which is why we believe pensions dashboards are required.

   The short answer here is No. We also don't believe members with larger pot sizes and saving regularly will be able to fully understand the charging structures or compare like for like if looking at effect on returns. This is possible but unlikely by using the Chairs statement on costs and charges projection.

It's dangerous to focus just on charging. An understanding of costs and charges should be balanced with an understanding of quality of service, options and crucially investment returns.

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 current system does not impede members from carrying out a comparison of costs and charges although this isn't the only factor a member should consider in a comparison. Comparing providers is more complicated than just charges.

The proposed changes will add complexity and may impede members understanding of costs and charges, though it's accepted the intent is to reduce the financial impact of charges on small pots.

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 don't agree Government should move to a universal charging structure. We believe this would likely lead to a lack of competition which, in turn would lead to a lack of innovation in pensions provision, a lack of schemes being able to adopt ESG and innovative investment facilities such as investment in illiquids and a withdrawal of providers offering attractive schemes to members which will help them maximise their benefits. We've already seen examples of this occurring since the default maximum was introduced and wouldn't want to see this accelerated.

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

We don't support standardisation of charges. However, we think standardisation has limited impact on other government initiatives such as simple annual statements and pensions dashboard as the variables are around contribution structures, scheme structure and investments which are beyond charges.

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're not convinced changing the charging structure will make a significant difference. We also don't believe comprehension of charges is the main obstacle to member engagement. The lack of traction achieved by Stakeholder pensions which sought to use simplicity of charges and product design regulation as a way of engaging members is evidence of this. This lack of comprehension is the same with AE schemes, despite AE being mandated. Member engagement is driven by:

- capacity to save
- incentivisation (which has been progressively removed by the gradually roll back of tax relief provisions)

- financial education
- the levels of contributions invested on their behalf

Member engagement is also often driven by employers and most AE employers have very limited engagement with workplace pensions.

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?

Most members don't choose a scheme based on the level of charges, they don't choose a scheme at all. The employer chooses the scheme and members are automatically enrolled. For many members, the most significant decision is whether to opt out, whether to transfer deferred pots to their new active pot, and limited consideration is given to charging structures by the member.

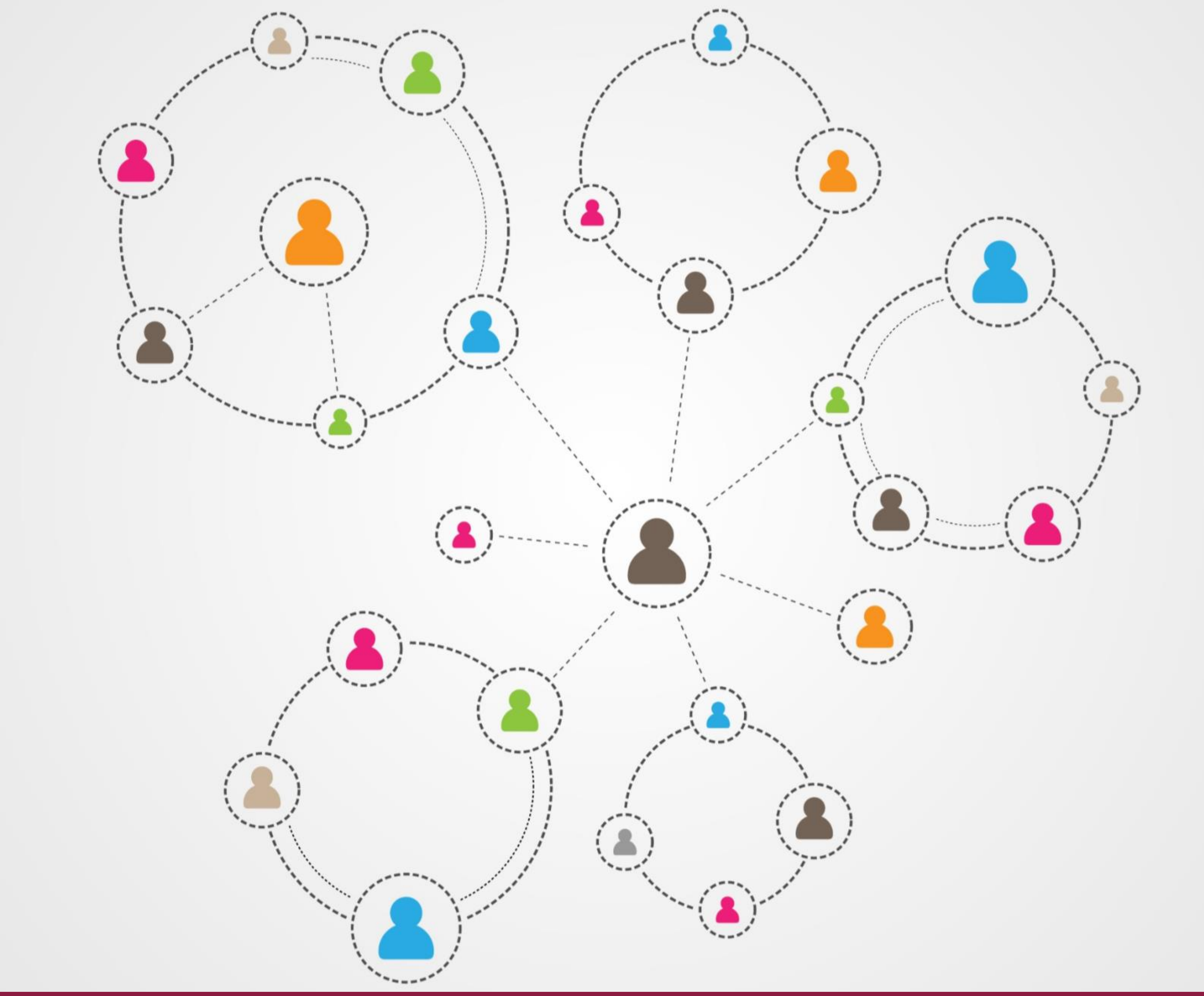
Other risks include lack of consideration of the impact of investment benefits, and a focus on non-growth asset classes driven by the perceived cost of investment. Such funds are a particular concern in a low to zero yield from deposit/cash type funds where the charges are however low. In an auto enrolment environment where members are very often unengaged (but still members of a scheme) they will often focus on the work done by employers to select a scheme on their behalf and the contribution paid into those schemes by employers rather than the charging mechanism. Other risks on using this selection basis only, is moving to a scheme with a poor service model, which could also create disengagement due to poor service or unengaging member tools and communications.

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?

Charges play an important role in employer's selection of the pension arrangement they choose for auto enrolment and this drives down price to members. The costs to employers of selecting schemes, interfacing with pension schemes, facilitating administrative data flows, paying over contribution deductions and then investment of monies, is significant and as a result they won't typically pay any contributions to other pension schemes an individual selects as an alternative to the employers selected arrangement. There's significant evidence of this behaviour in the period since personal pensions were first introduced through to the introduction of auto enrolment. We don't believe the implementation of a single charging structure will change their approach to selection as value for money is always a consideration for employers. All this does is change the lens used for analysis.

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?**

Employers routinely negotiate on charges amongst other criteria in selecting providers or employ advisers to do this on their behalf. Those employers who aren't engaged or whom don't have the cohorts of members attractive to providers, use Nest as the default choice. A good scheme from an engaged employer incentivised to make good provision on their member's behalf will create compelling contribution structures, encourage member education and build attractive schemes to which members are more likely to pay more than minimum levels of contributions. Employees own contributions will still be based largely on affordability and unless there's a material price difference communicated and understood by members to act on, we don't feel the negotiation process will duly affect savings rates.



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