Which? works for you

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Consultation Response

DWP Review of the Default Fund Charge Cap and Standardised Cost Disclosure

Introduction

Which? welcomes the Department for Work and Pensions' (DWP) review of the default fund charge cap for auto-enrolment schemes and standardised cost disclosure. The fees and charges taken from a person's pension savings when saving can have a significant impact on standards of living in retirement. An increase in annual fees from 0.5% to 1% of a person's fund would mean the individual having to raise contributions by around 10% in order to achieve the same pension fund. So protecting savers from high costs and charges is crucially important.

Individual members have little oversight of the scheme or the level of charges. Most are auto-enrolled onto a default selected by their employer and rely on a board of trustees or independent governance committees to ensure the schemes are offering 'value for money'. According to the Pensions Policy Institute, 91% of members of master trust schemes remain in the default investment.[1] However, as highlighted by the Competition and Markets Authority's recent market investigation, trustees and independent governance committees often lack the detailed information on fees and charges required to perform their role effectively by holding fund managers to account.[2]

The default fund charge cap that was introduced in 2015 has proven an effective protection against very high charges. Transparency of costs and charges has also increased somewhat in recent years. Which? believes that further reforms are required to ensure that savers are protected, including by resetting the level of the Default Fund Charge Cap, redesigning the Charge Cap, and by improving transparency and comparability of costs and charges by asset managers and pension schemes.

Resetting the level of the default fund charge cap

Which? believes that the design and level of the default fund charge cap can be improved to ensure that economies of scale and other efficiencies that develop are passed on to savers, and that savers with small pots are protected from excessive fees. The international evidence from

[1] Pensions Policy Institute (2019), *The DC Future Book*, p.16
[2] Competition and Markets Authority (2018), *Investment Consultants Market Investigation: Final Report*

countries with more mature defined-contribution pension industries suggests that costs and charges have fallen over time, which highlight the impact that economies of scale are likely to have. The US and Australia, for example, have seen charges declining at a rate of around 2% per annum as schemes mature.[3]

Recent research suggests that neither the charge cap nor the greater use of passive investment in the UK appear to have had a notable impact on returns.[4] Charges for UK master trusts and large contract schemes are already at or below 0.5%. This also suggests that there is headroom for schemes with sufficient scale to make such investments in patient capital, such as venture capital and infrastructure, without fear of breaching the charges cap. We have also previously indicated that we support separate DWP proposals for trustees to calculate compliance within the charges cap while making investments that have some element of performance related pricing.[5]

Which? therefore believes that the charges cap for default auto-enrolment investments can and should fall gradually over time. This would help to ensure economies of scale are passed on to consumers, while still helping pension schemes to plan for the future.

The DWP should:

- **Reset the level of the default fund charge cap, based on an assessment of pension schemes' actual costs.**
- **Consider whether the default fund charge cap should be placed on a downward price escalator in-between full reviews of the level of the cap.**

Redesigning the Default Fund Charge Cap

Which? agrees that savers with relatively small pension pots should be protected from their savings being eroded by flat fees, which are currently permitted under the charges cap for auto-enrolment. However, the DWP's initial modelling for potential minimum pot sizes for flat fees would still mean that savers could be paying as much as 5% of their pension pot each year in flat fees, alongside an annual management charge and transaction costs. This appears to be based on the presumption that pots should maintain their real value over time if no contributions are made. However we believe that pension schemes should set their charges based on the principle that all pension pots should aim to grow, even without additional contributions.

In principle, transaction costs should be included in the charges cap, given that it is the total costs and charges that matters to savers. This can also help to avoid unintended consequences whereby costs are shifted elsewhere into the system. However, there may be certain

[3] Pensions Policy Institute (2018), *Charges, returns and transparency in DC - what can we learn from other countries?*
[4] Pensions Policy Institute (2018), *Charges, returns and transparency in DC - what can we learn from other countries?*
[5] Which (2019), *Which?'s response to the DWP consultation: Investment Innovation and Future Consolidation*

circumstances where higher high one-off transaction costs are in the best long-term interests of savers and so should be permitted. This could potentially include cases where pension schemes change asset managers or transfer savers to another pension provider.

The DWP should:

- **Introduce a proposed minimum pot size for flat fees to be applied to active and deferred pension pots, which is based on the principle that all pots should have a reasonable chance of growing over time.**
- **Extend the default fund charge cap to cover transaction costs, with flexibility for one-off transaction costs under certain circumstances where the pension scheme can show that these are in the best interests of savers.**

Improving transparency and comparability of costs and charges by asset managers and pension schemes

Evidence from the Netherlands, in particular, shows that improved transparency is associated with lower costs and charges. Standardised cost disclosure was introduced in the Netherlands 2011. Adoption was initially voluntary, but became mandatory in 2015. The standardised cost data is also published by the Netherlands' central bank. This enables trustees to compare their costs with the sector more widely and to benchmark against other providers, using tools developed by third parties.[6]

In the five years from 2012, the average cost of asset management in the Netherlands fell from 66 to 54 basis points, corresponding to an 18% fall.[7] While other factors may also have contributed to this fall, this provides strong evidence of the impact an increase in transparency can have on the outcomes for pension scheme members.

In the UK, however, the detailed cost template developed by industry was not available until 2018 and it remains voluntary. While the DWP cites some evidence of take-up by asset managers and pension schemes, the full level of take-up is unclear. We also note that 14% of members are in schemes in which Trustees have failed to meet a requirement to 'assess the extent to which charges/transaction costs provide good value for members'.[8] Better availability of detailed costs and charges information is fundamentally important to address this, alongside improving the capability and effectiveness of trustees. We therefore believe all schemes should have this detailed information made available to them, as well as comparative information from wider industry.

DWP should also act to ensure greater transparency for savers of the total amount they have lost in costs and charges each year. As a matter of principle, consumers should be told how

[6] Pensions Policy Institute (2018), *Charges, returns and transparency in DC - what can we learn from other countries?*
[7] Pensions Policy Institute (2018), *Charges, returns and transparency in DC: What can we learn from other countries?*
[8] The Pensions Regulator (2018), *DC Research: Summary Report 2018*

much they have paid for their pension, just as they are for other products and services. This can also have direct benefits on charges, as the greater engagement this will encourage for scheme trustees or independent governance committees will lead to benefits for all members. In later life, members of defined contribution schemes must also make challenging decisions about how they access their pension savings and turn these into an income. Such decisions are made more challenging if vital information on how pension schemes function are hidden from individuals when they are saving towards their retirement.

The DWP consulted on proposals for simpler annual benefit statements in November 2019, but has yet to outline its conclusions. Which? believes these proposals were hugely important, and should also be taken forward.

The DWP should:

- **Require asset managers to complete a template for the disclosure of costs and charges to pension schemes.**
- **Require pension schemes to annually report scheme costs and charges to regulators using an industry template, and require regulators to publish the data in a standardised and searchable format.**
- **Take forward its existing proposals on annual benefit statements, by introducing a mandatory template for all defined-contribution schemes that requires schemes to show members a single figure for how much people have paid in costs and charges.**

About Which?

Which? is the largest consumer organisation in the UK with more than 1.5 million members and supporters. We operate as an independent, apolitical, social enterprise working for all consumers. We are funded solely by our commercial ventures and receive no government money, public donations, or other fundraising income. Which?'s mission is to make individuals as powerful as the organisations they have to deal with in their daily lives, by empowering them to make informed decisions and by campaigning to make people's lives fairer, simpler and safer.