Which?, 2 Marylebone Road, London, NW1 4DF
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Consultation Response

DWP consultation on *Permitted charges within Defined Contribution pension schemes*

Which? supports the proposal to implement a de minimis below which the flat fee element of the combination charge cannot be charged to members

Which? welcomes the Government's commitment to improving outcomes for those automatically enrolled into a pension scheme. Prohibiting the charging of flat fees on very small pots worth £100 or less is an important measure to prevent so-called 'charging out' and the dissatisfaction felt by savers who find a pension pot has been completely eroded by charges.

We also welcome that the level of the de minimis is to be kept under review. The proposed de minimis won't prevent all pot erosion as deferred pots valuing as much as a few hundred pounds could be 'charged down' to £100, likely creating similar feelings of discontent for savers to those the current proposal seeks to prevent. Therefore, if a solution cannot be swiftly found to facilitate the consolidation of small deferred pots then it may be necessary to increase the level of the de minimis or to revisit the option of a tiered approach in future.

We also agree that improved transparency of charges is important to engender greater member engagement and higher levels of trust. However, we are not yet persuaded that mandating a single, universal charging structure for automatic enrolment default funds is the best way to achieve this. While we favour making cross-scheme comparison of costs and charges easier for members, there is uncertainty around the scale of both the potential benefits and costs that such a change would bring. Requiring schemes to show a personalised pounds and pence figure for costs and charges on annual benefit statements and at pensions dashboards would be a less costly action for schemes to take and it may be a more effective measure, so we think this should be the immediate priority.

Answers to specific questions

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

Yes, the proposed de minimis should apply to all active and deferred pots. Applying it to active pots provides protection for members with very low contribution rates and will help them to establish a pension pot.

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

It is important that if a member holds multiple pots of less than £100 with the same provider then the de minimis should be applied to all of these pots. Ideally, pension providers should be consolidating pots owned by the same member. The Pensions Policy Institute estimates that such same scheme consolidation would make a meaningful contribution to reducing the number of pots in masters trusts[1], and current best practice among master trusts is to provide a single account for members. Applying the de minimis to all of a member's pots in the same scheme should provide an incentive for schemes to carry out same scheme consolidation.

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?

It is unclear whether the de minimis would have a material impact on a consolidation of deferred small pots across schemes as this would depend on the process through which consolidation occurs. However, on the evidence available we do not think the de minimis would be a material barrier to potential consolidation of most deferred small pots.

At trust-based schemes, trustees will need to be persuaded that a member will not be made worse off by the transfer and this is likely to prevent the consolidation of many pots. The current member exchange pilot between master trusts will provide good evidence on whether this is the case, but it seems likely that trustees will choose not to transfer any pot to another scheme with higher charges. For very small deferred pots this would mean there would be no viable transfers into a scheme with a flat fee charge from any scheme with an alternative charging structure unless the trustees can know that the combined pot will be of sufficient size to avoid being eroded by the flat fee. Crucially, this would be the case regardless of whether the de minimis is introduced.

The de minimis may make some transfers less likely, but this would be a relatively small set of transfers that would have to satisfy the following exacting criteria:

1. be between two schemes that both charge a flat fee;
2. be to a receiving scheme with a charge that is not higher than the ceding scheme;
3. combine a pot of less than £100 from the ceding scheme (i.e. a pot that would be subject to the de minimis) with a pot at the receiving scheme that is not known to be large enough that the flat fee will be covered by investment growth (i.e. where the combined pot will be sufficiently large that the transferred pot will not be eroded).

[1] Pensions Policy Institute (2020), *Policy options for tackling the growing number of deferred members with small pots*

If it is the case that schemes are unwilling to transfer pots whenever there is a risk that charges may make an individual worse off, then large-scale consolidation of small, deferred pots will only happen if the government intervenes to take away some liability from trustees and scheme managers. In such circumstances, the government could also act to ensure that the de minimis does not act as a barrier to consolidation.

Therefore, we do not think the potential for the de minimis to inhibit scheme consolidation is a strong argument against its introduction.

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?

There is overwhelming evidence that members have a lack of understanding of charges in defined contribution pensions, see for example OFT (2013) and FCA (2019).[2] We have no reason to suppose that this is not also the case for members in automatic enrolment schemes.

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?

Decision-making complexity lowers consumer engagement and makes it more difficult for consumers to make a good choice. Complex costs and charges will make comparison between schemes less likely as it will reduce member engagement. However, there are other reasons for low levels of engagement with defined contribution pensions. A lack of transparency about how much a member pays in costs and charges will inhibit engagement. Further, members with low value pension pots will be less motivated to engage, and this is a strong argument to increase consolidation of 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?

On balance, we are not yet persuaded that a move to a universal charging structure for default funds is required at this time. As the consultation states, different charging structures can be of benefit to members depending on the size of the pension pots and our caution towards a

[2] Office for Fair Trading (2013), *Defined contribution workplace pension market study*; FCA (2019), *Effective competition in non-workplace pensions*

universal charging structure is a consequence of the uncertainty surrounding both the costs and benefits of such a move.

In terms of costs, it is unclear what impact mandating the use of only an annual management charge would have on the financial sustainability of schemes that currently have alternative charging structures. The distributional impact across members would also have to be carefully explored as some members may be made worse off by a universal charging structure.

With regard to benefits, we think that increased transparency in which members know how much they are paying for the management of their pension is a necessary condition for improving engagement. One type of better engagement might be more members exercising a choice to switch funds within their existing provider or to switch provider completely, but we're sceptical about the potential for many people in auto-enrolment default funds to do this or indeed the value of the benefits it might lead to. There is a stronger argument for standardisation in non-workplace pensions where consumer choice is necessary, but where charging complexity has made this more difficult.[3]

In auto-enrolment schemes which are chosen by employers and which have trustees and independent governance committees to consider value for money, we think it is more important to promote engagement with the question of how much an individual should save, rather than where it is saved. Our research has shown that the automatic enrolment contribution rates are likely to lead to lower pension savings than might be desired by many people.[4] Given this, we think it would currently be better to make engagement easier by using other methods to make awareness and comprehension of costs and charges simpler, see question 12.

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

Simpler statements and pensions dashboards are essential tools for improving the nation's engagement with their pension savings. These initiatives can only be successful if the right data, including on charges, is presented transparently and in a standardised way.

There is some international evidence that transparency on charges for consumers has had a positive impact on engagement as well as helping to create a relatively high level of consumer trust in the pensions industry.[5] Better understanding of what individuals pay for their pensions is also crucial to prepare people for when they are confronted with decisions in later life, when people with savings in defined-contribution schemes must make challenging decisions about when and how they access their pension savings.

[3] FCA (2019), *Effective competition in non-workplace pensions*
[4] Which? (2019), *Top up the Pots: Achieving adequate retirement incomes with automatic enrolment*
[5] Pensions Policy Institute (2018), *Charges, returns and transparency in DC - what can we learn from other countries?*

The use of a universal charging structure would make transparency easier, although we think this could be achieved sufficiently by requiring schemes to show a personalised pounds and pence figure for costs and charges on annual benefit statements and pensions dashboards.

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?

Some schemes voluntarily provide pounds and pence figures for costs and charges already, and all income drawdown providers are also required by the FCA to show this information. We believe all schemes should be mandated to show a personalised pounds and pence figure for costs and charges on annual benefit statements and pensions dashboards.

If greater transparency can be achieved with a pounds and pence charge then we believe there will be less concern about differences in the underlying charging structure. Given that only a very small proportion of people saving into a default fund are likely to make a decision to switch provider through a member-led transfer, there seems to be only a very low risk that people might mistakenly switch to a higher charging fund on the basis of this information alone.

About Which?

Which? is the UK's consumer champion. As an organisation we're not for profit - a powerful force for good, here to make life simpler, fairer and safer for everyone. We're the independent consumer voice that provides impartial advice, investigates, holds businesses to account and works with policymakers to make change happen. We fund our work mainly through member subscriptions, we're not influenced by third parties and we buy all the products that we test.

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