PENSIONS POLICY INSTITUTE

PPI

What is the impact on member outcomes of different non-capped charging structures?

Executive Summary

The Pensions Policy Institute (PPI)

We have been at the forefront of shaping evidence-based pensions policy for 20 years.

The PPI, established in 2001, is a not-for-profit educational research organisation, with no shareholders to satisfy – so our efforts are focussed on quality output rather than profit margins. **We are devoted to improving retirement outcomes.** We do this by being part of the policy debate and driving industry conversations through facts and evidence.

The retirement, pensions and later life landscapes are undergoing fast-paced changes brought about by legislation, technology, and the economy. Robust, independent analysis has never been more important to shape future policy decisions. The PPI gives you the power to influence the cutting-edge of policy making. Each research report combines experience with independence to deliver a robust and informative output, ultimately improving the retirement outcome for millions of savers.

Our **independence** sets us apart – we do not lobby for any particular policy, cause or political party. We focus on the facts and evidence. Our work facilitates informed decision making by showing the likely outcomes of current policy and illuminating the trade-offs implicit in any new policy initiative.

Our Vision:

Better informed policies and decisions that improve later life outcomes

We believe that better information and understanding will help lead to a better policy framework and a better provision of retirement income for all.

Our Mission:

To promote informed, evidence-based policies and decisions for financial provision in later life through independent research and analysis

We aim to be the authoritative voice on policy on pensions and the financial and economic provision in later life.

By supporting the PPI, you are aligning yourself with our vision to **drive better-informed policies and decisions that improve later life outcomes** and strengthening your commitment to better outcomes for all.

As we look forward now to the next 20 years, we will continue to be the trusted source of information, analysis, and impartial feedback to those with an interest in later life issues. The scale and scope of policy change creates even more need for objective and evidence-based analysis. There is still much to do, and we look forward to meeting the challenge head on.

For further information on supporting the PPI, please visit our website: www.pensionspolicyinstitute.org.uk or contact Danielle Baker, Head of Membership & External Engagement, at danielle@pensionspolicyinstitute.org.uk

The future is ever changing, but the PPI remains a constant "Voice of Reason" in the ongoing debate on the future of retirement in the UK.

Pensions Policy Institute PPI EST. 2001

This report has been authored by:

Tim Pike – Head of Modelling

Tim is the Head of Modelling of the PPI, responsible for delivering the models and modelling to support the PPI's current research program. He joined the PPI in July 2015 and since then has analysed the projected implication of pension policies upon many significant groups. These have included the self-employed, women, younger generations, and the Exchequer.

Tim has worked alongside academics and other researchers on collaborative projects including WHeRL and CASPeR. These projects bring multidisciplinary research to widen the scope and give a more complete view of the implications of interacting areas of policy.

Prior to joining the PPI, Tim worked for Legal and General where he spent nearly ten years contributing to a wide variety of actuarial modelling projects, from financial reporting to annuity pricing.

Tim has an MA (Cantab.) having studied mathematics at Fitzwilliam College Cambridge.

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A Pensions Policy Institute report

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Executive Summary

This research sets out to answer the following question:

What is the impact on pension schemes and member outcomes of different non-capped charging structures?

There are several criteria for a money purchase workplace pension scheme to qualify for automatic enrolment. This includes being subject to a charge cap. Outside of automatic enrolment there are no caps upon charges schemes can levy (with the exception of Stakeholder schemes).

This report sets out the proportion of pension scheme membership subject to capped charges; outlines the scale of uncapped charges in the market; identifies how non-capped arrangements differ from capped arrangements; analyses the at-retirement impact on members; and considers how the market may evolve as a result of charge cap development.

This report concludes that:

- Scheme selection and fund choice by employers choosing a scheme for their employees is not primarily driven by charges;
- Members are not generally engaged with charges and transfers are generally not motivated by charges;
- Outside of the scope of the charge cap the level of fees has been driven down in recent years, however a charging gap remains between non-capped and capped arrangements;
- Most default investment strategies charge below the cap, eroding a typical pot at retirement by 14% – a quarter less than the impact of charges at the cap;
- Members of non-default investment strategies and Self Invested Personal Pensions (SIPPs) may incur higher charges, and will need to realise additional benefits, such as a wider range of assets to invest in, to offset higher charges;
- Providers of schemes designed for pot consolidation are advantaged by not being subject to the cap, and can therefore charge more than automatic enrolment schemes. However, members of these schemes may be disadvantaged through incurring higher charges unless they see other benefits, such as higher returns;
- A combination of the Government measure that pots worth less than £100 cannot incur flat fees from April 2022 and an increase in consolidation schemes could disadvantage members who remain saving within automatic enrolment providers by reducing their value for money.

This summary draws out the key findings from the research and serves as the report's conclusions.

Scheme selection and fund choice by employers choosing a scheme for their employees is not primarily driven by charges

When employers select a scheme to act as a workplace pension scheme to fulfil their obligations under automatic enrolment, the charging structure, and therefore its suitability to members, is not one of the primary concerns.

Members are not generally engaged with charges and transfers are generally not motivated by charges

When pension savers switch between schemes, they are primarily concerned about potential investment performance rather than the scheme's charges.

Outside of the scope of the cap charge the level of fees has been driven down in recent years, however a charging gap remains between non-capped and capped arrangements.

The average charge in non-qualifying workplace schemes has decreased markedly in recent years, closing the charge gap between qualifying and non-qualifying schemes to 0.05% of assets under management (AUM). The closing of the charging gap is assumed to be, at least in part, the result of competitive pressure exerted from schemes subject to the charge cap.

Further pressure has been applied from a level of 1% of AUM a year being taken as a benchmark of value for money by Independence Governance Committees (IGCs) where the charge cap does not apply. 14% of assets in legacy schemes still attract charges above 0.75% of AUM.

Most default investment strategies charge below the cap, eroding a typical pot at retirement by 14%, a quarter less than the impact of charges at the cap

Typical charges in a qualifying scheme erode retirement savings by around 14%. Annual charges in these schemes are around two-thirds of the level of the cap. Charges at the level of the cap, which are more indicative of individual personal pensions, erode retirement savings by around 20%. Where personal pension charges are even higher this will erode retirement savings by a yet greater proportion.

Members of non-default investment strategies and SIPPs may incur higher charges and will need to realise additional benefits, such as a wider range of assets to invest in, to offset these higher charges

Charging structures of SIPPs are more complex, more varied and are typically higher than workplace pension schemes. This reflects their target markets and their sensitivity to costs and investment choice. Such schemes may have a wider range of investment options which may appeal to experienced investors who are interested in asset classes that may not be suitable for schemes and funds which are subject to the charge cap. However, consumers will attempt to keep decisions simple rather than engage in the trade-off between benefits and charges and if they do not realise these benefits they will only be worse off with higher charges.

Providers of schemes designed for pot consolidation are advantaged by not being subject to the cap, and can therefore charge more than automatic enrolment schemes. However, members of these schemes may be disadvantaged through incurring higher charges unless they see other benefits, such as higher returns

Providers of schemes designed to accept transfers in and consolidate schemes have a fundamental advantage over providers targeting the automatic enrolment market. While they are out of scope of the charge cap, they should be able to offer more competitive charges as they do not have to support the costs of small pots through cross-subsidisation. This situation is linked to the issue of small deferred pots which puts charging pressure on providers who target the automatic enrolment market. Such providers end up managing many uneconomic small inactive pots which will not receive contributions to grow to an economically viable size. This pressure has implications for the members who are paying charges which subsidise the uneconomic pots.

A combination of the Government measure that pots worth less than £100 cannot incur flat fees from April 2022 and an increase in consolidation schemes could disadvantage members who remain saving within automatic enrolment providers by reducing their value for money

Flat fees reduce the need for cross-subsidisation from members with larger pots to those with smaller pots. For schemes which have a larger proportion of small, deferred pots this will place additional pressure on the cross-subsidisation of these pots. This balance is exacerbated when pots which provide the cross-subsidisation are transferred out of the scheme. What does the cross subsidisation/higher charge income provide.