

Review of default charge cap and cost disclosure

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Introduction

On 25 June 2020, the DWP published a [call for evidence](#) seeking views on the effectiveness of costs, charges and transparency measures in protecting pension member outcomes (“the Call for Evidence”). This Call for Evidence, together with a Pension Charges Survey, will inform the Government’s review of the default fund charge cap (“the Cap”).

Key points

- Potential proposals for revising the Cap include: bringing transaction costs and certain life assurance add-ons into scope, lowering its level and restricting the use of flat fee structures for small pots.
- The DWP is also exploring policy options for increasing the use of the Cost Transparency Initiative’s (“CTI”) templates as a standardised form of cost disclosure.

The Cap

Background

The Cap was introduced in 2015 with the aim of protecting individuals who are automatically enrolled into a pension scheme from “high and unfair charges”. Set at 0.75%, it applies solely to the default fund of DC auto-enrolment schemes (subject to certain exceptions) and covers all member-borne charges associated with scheme and investment administration, except transaction costs and a small number of other specified costs and charges. (See [DC default fund charge cap: what’s in and what’s out](#) for full details).

In 2017, the Government carried out an examination of the level and scope of the Cap. It concluded that the Cap was operating as intended, and did not make any changes. The Government committed to review the level and scope of the Cap again in 2020. The Call for Evidence and Charges Survey will inform that review.

Scope

The Call for Evidence also suggests that where a scheme member has been defaulted into a life assurance arrangement and is unable to opt out, the associated costs should be included in the Cap

This was considered originally but, following feedback that including them could restrict the ability of asset managers to trade and that there was a lack of adequate transparency in the area of transaction costs, they were ultimately excluded. In the 2017 review, the Government decided to delay bringing transaction costs into scope to allow time for the FCA's new rules on transparency (a duty on asset managers to provide information on transaction costs to trustees and providers) to bed in.

While some of the previous challenges remain, steps have been taken to improve issues around cost calculation and disclosure, for example the FCA's rules on transparency mentioned above, and a settled measure of transaction cost reporting, which the Government supports. As an alternative, the Government notes the possibility of a separate cap for transaction costs.

The Call for Evidence also suggests that where a scheme member has been defaulted into a life assurance arrangement and is unable to opt out, those costs should be included in the Cap. This reflects the Government's position that charges borne by scheme members should be fair and only relate to services that add value to their pension saving. The Government recognises that these arrangements are rare and can improve the member journey but is concerned about defaulting people into products they may not need or want, prices drifting up with no backstop, and cost transparency.

Level

The upcoming Charges Survey will gather evidence from providers on current costs and their drivers, to inform the review of the level of the cap. The DWP is mindful that there are arguments both for and against making a change. For example, while a decrease might further improve value for members, it could also limit schemes' ability to diversify their portfolios.

In February 2019, the DWP launched its Investment Innovation and Future Consolidation consultation (see [7 Days](#)). This looked at the interaction between the Cap, illiquid investments and performance fees and proposed an additional method to give trustees more flexibility to pay performance fees (to help remove any potential barrier to investing in asset classes that attract such fee structures). A consultation response, together with proposals to address this issue are promised "in the Autumn".

Restricting flat fees

Currently, the Cap permits charging based on a percentage of funds under management combined with a flat annual fee (subject to limits on each element). Flat fees provide the greatest benefit to those with the largest funds and those who contribute over a number of years. However, for those who save for a short period, flat fees can result in higher charges. This is because a flat fee is levied on the pot each month irrespective of whether contributions continue to be paid. Savers with small pots could have the balance left in the fund charged out to zero before they reach retirement, even with a reliable annual investment return.

The Call for Evidence seeks views on limiting the use of flat fees for smaller pots. It suggests a sliding scale could be used, restricting the level of cost depending on the value of the pot, eg a fee of £5 or less can't be charged unless the pot is at least £100, between £5 and £10 can be charged for pots over £200 etc..

Standardised cost disclosure

Following a [study by the FCA](#) which concluded that institutional investors found it difficult to obtain the necessary cost information to accurately compare costs, the CTI produced templates aimed at providing trustees with standardised cost and charges information from asset managers (see [7 Days](#)).

Following the Work and Pensions Select Committee's recommendation that the Government mandate the use of the CTI disclosure templates for both DC and DB schemes, the Government is now exploring how best to achieve full take-up. "The more standardised and detailed the information which trustees are able to

obtain, the better equipped they will be to pinpoint where costs are being incurred and to make detailed comparisons”.

So far early indicators of voluntary adoption have been positive, although the scale of take-up across the market is yet to be determined and industry-wide adoption is not expected for some time. While compulsion is a possibility, the DWP’s “preference” is to encourage wider adoption of the templates by legislating for disclosure of their usage via the scheme return.

Next steps

The Call for Evidence will run until 20 August 2020. The DWP “will engage with industry and other interested stakeholders both formally and informally” throughout its review and aims to bring forward proposals “later this year”.

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