Financial Services Consumer Panel

AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Financial Services Consumer Panel response to Department for Work & Pensions (DWP): Permitted charges within Defined Contribution pension schemes.

Dear Sir / Madam,

The Financial Services Consumer Panel (FSCP) is an independent statutory body. We represent the interests of individual and small business consumers in the development of policy and regulation of financial services in the UK.

The Panel welcomes the opportunity to respond to this consultation on permitted charges with Defined Contribution (DC) pension schemes.

We agree that harm to consumers from high charges is particularly acute where charges can reduce the size of small pots to zero.

However, the panel also believes that two key elements of any policy should be;

1. To encourage members to review and increase their contributions, as appropriate, to ensure they have the income in retirement they require, and
2. To have an effective means of transferring small pots, so that a consumer's multiple pots can be quickly and easily combined, therefore removing the risk that flat fees present

The Panel has an open mind regarding the introduction of a £100 threshold below which the flat fee element of the combination charge used by pension providers, cannot be charged to members. In the current situation we see this as a means of preventing small pots being drained to zero – however this does not address the more strategic issues and does lead to an increased level of cross subsidisation from large pots to smaller pots. Furthermore, we would question (if a threshold is to be applied) whether the £100 hurdle is too low.

The Panel proposes that DWP should therefore consider 'permitted charges within DC pensions schemes' alongside its work (with the small pension pots working group) on small pension pots.

We would also propose that it may make sense to delay any decision on policy changes on permitted charges until after the launch of the Pensions Dashboards, when consumers (those that want to) will have the ability to review all their pensions in one place and make better and easier consolidation decisions. There is the possibility that with the dashboards and small pot strategies in place, the proposed changes to charging may not be required.

Finally, the Panel supports requirements to ensure charging approaches are simple and easy to understand for consumers. It is important, as part of simplification, and to aid understanding, that past and future charges are communicated to consumers *both* as a percentage, and in terms of Pounds and Pence.

Yours faithfully,

Wanda Goldwag
Chair, Financial Services Consumer Panel

Responses to questions

Q1: Do you agree with our proposal that the de minimis should apply to all active and deferred pots? If not please outline why.

The Panel agrees with an intention to stop pension pots being drained to zero by the application of flat fees.

We believe there are a number of additional issues that should be included in this thinking.

1. Consumers should be better supported and guided in understanding the appropriate level of pension contributions required to support their income requirements in retirement.
2. DWP should continue to focus on providing a solution to reduce the increasing number of small pots (supported by the Small pots working group). Bringing a consumer's various small pots together would make the overall pots easier to manage and understand and also reduce the impact of any flat fees.

Where small pots remain unconsolidated (with a consumer's other pots) the panel believes it is important that fees and charges (especially the flat fee element) do not drain the pot to zero. This is not only a poor outcome for the consumer but also for public confidence in pensions.

The challenge with applying the de minimis, below which a pot will not attract a flat fee, is that this likely to create a further cross-subsidy between larger pots and those below the de minimis. We believe any change in policy in this area should also include the obligation on IGCs and Trustees to understand, manage and be accountable for any cross subsidies in schemes under their remit. This should ensure that they consider fairness and value in setting and agreeing charges.

Finally, in DWP's impact assessment[1], they note that average ongoing charges are 0.48%, which is below the 0.75% cap. A potential consequence of removing fixed charges for pots under £100 could be higher average charges, or higher fixed charges for pots over £100. The Panel suggests, should this policy be implemented, that DWP closely monitor if charges change as a result of this policy, and the impact on different cohorts of consumers with further intervention being considered if required.

Q9: 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?

[1] https://www.gov.uk/government/consultations/permitted-charges-within-defined-contribution-pension-schemes/impact-assessment-occupational-pension-schemes-charges-and-governance-amendment-regulations

And

Q10: 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?

The current system introduces a level of complexity that makes it difficult for consumers (for those that want to) to understand and compare charges. Many studies have shown that consumers can struggle to work out how much they will pay in Pounds and Pence from the percentages they are given[2], and yet this is clearly needed for consumers to understand and compare actual and/or potential charges across different pricing approaches.

The panel therefore supports a requirement for simple and easy-to-understand charging approaches, that communicate past and future charges as *both* Pounds and Pence, and percentage figures.

We are open-minded regarding a move from the current 3 permitted charging structures within the default fund arrangement, down to a single charging structure but have concerns around

1. This being a policy development that may not help consumers as intended. We would want to better understand the proportion of consumers in default funds that would want, or benefit from, a single charging approach.
2. Whether this would increase the level of cross-subsidy, between members, across a scheme, and
3. Without the appropriate guidance, tools and support a change in charging approach alone will not help the majority of members in the default fund make better choices or achieve better outcomes.

Q12: 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?

Simple, easy to understand information is key.

Members should also be informed of any actions they could take to reduce the charges they attract (that do not reduce potential returns or increase risk). This would help members better engage with their pension, and the associated charges, and make decisions that can improve their outcomes.

Q13: 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?

[2] Nearly six in 10 (59%) UK adults struggle to work out what a percentage fee equates to in pounds and pence, according to research by Interactive Investor 2021 (https://www.yourmoney.com/investing/could-you-correctly-calculate-a-percentage-fee/)

There are a number of risks that members may (unwittingly) be making if they make decisions based purely on the level of charges, including:

- Moving to poorer performing funds.
- Moving to poorer governed funds.
- Moving to funds with higher risk or volatility.
- Moving to schemes with poorer administration.
- Loss of benefits, such as online management and phone support.
- Moving out of ESG/Sustainable investments.
- Being charged to move – this may include exit fees, redemption fees and spread fees.
- Loss of benefit from being out of the market during the transfer.
- Moving to schemes / funds with 'hidden' charges (that they either don't currently face or are higher) such as exit fees, valuation on divorce fees and drawdown fees. etc
- Higher exposure to scams.
- Potential, that by combining pots, the current small pot lump sum £10,000 limit might be exceeded impacting future Lump Sum decisions.
- Reduced investment options in future.
- Reduced drawdown options in future.

These needs to be openly communicated to members (by both the ceding and receiving scheme) in an easy to understand way, to enable the consumer to make a well-informed decision on the wider aspects of a move, not solely the impact on charges.