The-Pensions-Net-Work
"Leading Thought In The Employee Benefits Market"

Response of The-Pensions-Net-Work to the NAPF consultation
"Telling Employers about DC Pension Charges"

About The-Pensions-Net-Work and how we put our response together

The-Pensions-Net-Work is a group of leading pension industry specialists from a wide variety of fields with a management board which is chaired by John Moret. We meet quarterly and receive presentations from thought leaders and debate the key issues of the day.

Thirty members of The-Pensions-Net-Work gathered in Hertfordshire in June and spent some time discussing the NAPF's consultation paper.

This paper represents our collective thoughts on this important subject. We believe that we are a unique contributor to your consultation, having an unparalleled breadth of expertise and no particular axe to grind.

Executive Summary

We believe the proposal is an excellent start, and shines some useful light on what will be a difficult decision for the employer, namely the choice of a pension scheme for auto-enrolment. We like the two page format and the graphic design, and believe that is an appropriate layout for employers to understand.

Shining the light separately on consultancy charging, and services provided, in the way proposed will help the employer in deciding the appropriate level of services to purchase, and the appropriate split of charges between fees and commission/consultancy charge.

But we have a number of significant reservations:

1. This is not needed for schemes arranged via a fee paying adviser, who is already doing this work to a rather higher standard anyway. The code should be restricted to direct sales to employers and sales involving commission or consultancy charging.
2. The timescale of January 2013 is very optimistic, given the other changes going on at the moment. However, restricting the code to direct or commission/consultancy charge sales means that it is only likely to be needed once smaller employers reach their staging dates, perhaps from mid 2014.
3. The pie charts should not show numbers as pounds shillings and pence. Compound interest will distort these and may make them appear frighteningly high, potentially deterring either or both employer and employee from high quality pension provision. The charges should all be clearly stated, and the effect expressed as a reduction in yield. But we would retain the pie chart approach, showing a nominal charge free yield of 6% as 360 degrees, and the reduction in yields for consultancy charges and provider charges as RIY pie slices out of that 6%.
4. It is great that the industry is working together to set this up. But it will then require teeth and enforcement, and should be handed over to The Pensions Regulator once a workable approach has been determined.
5. The sample member approach is aiming too low. With modern technology at our disposal, we should model all potential scheme members using their actual age, earnings and contribution basis, and collate the charges together into one overall scheme reduction in yield for comparison purposes.
6. The working group needs to engage with FSA, with a view to getting FSA disclosure regulations amended so that they come into line with this new format.
7. The idea of members remaining for many years after contributions cease may need to be reviewed in the light of Government's consultations on small pension pots.
8. We believe the position of smaller employers may need special consideration. It may be appropriate to "exempt" smaller employers – at least initially.
9. We have concerns about "legacy" pension schemes which do not appear to be addressed by the code. In our experience the impact of charges on these schemes –particularly those that are contract based –can prove very difficult to unravel particularly where they are "paid-up".

Response to some of the specific questions

Q1. Is the coverage specified the right one?

A1. We support the concept of disclosing charges in a clear manner before the employer makes his decision. And this needs to be all charges in order to defuse the issue of "hidden charges". Some charges may need to be estimated, where for example they will depend on how frequently a fund manager turns over the portfolio.

But we are concerned about the format for showing the "effect" of charges. We fear that it could be counter-productive to try and add these together into a total pounds, shillings and pence figure. The effect of compound interest over the long durations associated with a pension plan can produce huge sums that are virtually telephone numbers, and expressing charges in this way may put people off. They could put employers off leading to a "dumbing down" of pension schemes to the statutory minima or put employees off, leading to higher opt-out rates.

Instead we believe that the results should be presented as 6% being the expected yield in a charge free environment, with the effect of scheme and consultancy charges being shown as a reduction in yield. The pie chart format is visually powerful and should be retained, with 6% representing 360 degrees of pie.

Q2. Does the remit of the charge code seem appropriate?

A2. No.

Whilst we support the concept, we feel that the two page summary is completely un-necessary for employers that have hired a fee based adviser to help them choose a scheme. These advisers are already doing this work, and doing a much better job of it. Requiring them to add simplistic two pagers into their work as well is not productive.

But we do feel that the code is needed, and should be mandatory, for all pension schemes arranged directly by an employer without advice, or arranged by an employer with advice paid for through either commissions or consultancy charges. However we have some concerns about the practicalities of introducing this code for very small employers. We suggest that at least initially the code should be optional where the size of the workforce is below a "de-minimis" level – perhaps 5 employees – or where the pension arrangements are of an individual nature e.g. SSAS or SIPP.

We are concerned that a lot of parties are involved here. In some ways this is inevitable, as a lot of parties are taking charges out of the scheme and the underlying funds. But clarity will be essential as to exactly who is responsible for what in producing this document.

Q3. Do you agree with the proposal for a Summary of Charges Document as described?

A3. Subject to a number of reservations set out in our response, we support the principle of a Summary of Charges document and believe that it will shed light on matters pertinent to the decision that employers must make.

We also support the idea of the industry working together to establish the code and believe this is preferable to having legislation imposed on us by MPs that may not fully understand the complexity of the issues involved.

But we believe that to be effective the code needs to be mandatory. It needs to be enforced by a regulator, and The Pensions Regulator seems the obvious choice.

We applaud the concept of setting out what the service providers are delivering for the charges being levied.

Q4. Is the maximum length of two A4 pages appropriate?

A4. Yes, we feel this is the maximum that a lay employer can reasonably be expected to take in

Q5. For a short document, does the Charges Guide cover the right areas and present the effect of charges in a balanced way.

A5. We support the principle of showing consultancy charging separately. We believe that this will assist employers with the difficult task of deciding which of the services that are being provided by an IFA to support the pension scheme should be paid by the employer, and which by the members.

Q7. Are the characteristics of the sample scheme member appropriate?

A7. We have reservations about using a sample member in this way. It may be unrepresentative of the scheme as a whole and may lead to a "gaming" effect, with charging structures being created that look favourably at the sample scheme member point, but actually are rather worse for other members who are , say, older or lower paid.

We believe that the entire potential scheme population should be modelled, and the answer gathered together in pie charts representing the whole scheme. This can be achieved relatively easily with some bespoke middleware to do the modelling.

Q9. Do you agree that the Charges Guide should show the effects of charges both at the point of ceasing contributions and at the point of retirement? Does the extra sentence in the case of active member discounts help improve their visibility?

A9. Yes, we support the concept of showing the charges both after five years contributions and then after a further period of deferment.

We particularly support the five year period, and believe this is much more relevant to a modern workforce than the traditional FSA disclosure approach of naively assuming that members maintain paying contributions all the way through to retirement.

We support exposing schemes that levy higher charges of leavers. This is effectively achieved by the second 30 year pie chart.

The idea of a member remaining in the scheme for many years after contributions have ceased may become redundant depending on the outcome of the Government's current consultation on small pots.

Q10. Will providers have the capability and capacity to provide bespoke modelling at the employer's request? What lead in time is needed for this?

A10. We believe that all illustrations should be "bespoke", using the actual scheme data for all the potential members.

Providers will have the capacity to do this, but not in January 2013. There is just too much work on already with auto-enrolment and RDR.

We believe this could be in place within two years, which is when the code is really needed in terms of the roll out of staging dates of auto-enrolment.

Q12. Do you agree that the technical assumptions should match those for SMPI's?

A12. No

SMPI's are designed to show the likely size of pension that will be achieved from the contribution being made, whereas this exercise is intended to facilitate the comparison of two different pension scheme's charges.

We believe that the charge disclosure should assume a standard investment growth rate of 6%, and that the results should be presented as a reduction in yield from this 6% figure.

We are also concerned that the proposed disclosure does not sit comfortably with existing FSA rules. We recommend that the working party engage with FSA and seek FSA's support for the code and FSA's acceptance that existing FSA disclosure rules should be amended to bring them into line with the new code.

Q24. Will it be possible for providers to implement the Code of Conduct by the turn of the year?

A24. No. There is just too much work on already with auto-enrolment and RDR.

We believe this could be in place within two years, which is when the code is really needed in terms of the roll out of staging dates of auto-enrolment.

Q27. Do you have any other comments on the code of conduct?

A27. The concept of this code does not support the fact that the process of scheme selection may be iterative, or the fact that the employer is trying to get the best pension outcome for his employees, rather than the lowest charges.

In terms of selection, some employers ask for a simple recommendation from their adviser, others ask for a beauty parade. The decision to ask for a beauty parade may only come after the EBC has held a number of exploratory meetings with the employer, but fee levels will rise at this point to cover the additional work of organising a beauty parade.

Salary sacrifice is a good example of where incurring additional expenses can improve member outcomes. It will cost more for the adviser to implement a salary sacrifice arrangement, as more time will need to be spent on member communications. Additional member benefits arise from salary sacrifice, which are anticipated to be significantly higher than the costs involved. But the extra benefits won't even appear in the proposed disclosure pie charts, as they manifest themselves in enhanced take home pay for the individuals concerned.

We are unclear whether this material will also be made available to employees. Whilst it is aimed at employers, in a spirit of openness and honesty it is hard to argue that it should not be available to employees. But it might put them off joining, particularly if the slices of the pie chart are expressed as pounds and pence. Compound interest will result in some large numbers here even for what informed people would regard as low charge schemes, and that could encourage the poorly educated to opt out. Employers might even fall foul of the anti-inducement legislation by showing this information to employees if it encourages opt-out.

The NEST scheme has a public service obligation and as such becomes a natural benchmark. We wonder whether there should be a requirement on employers to consider the benchmark NEST figures, and for schemes that are charging more than NEST to show clearly in the “services rendered” section what it is they are doing that would justify an employer incurring higher charges on behalf of his employees.

Consultancy charges put the regulators feet to the fire. The more demanding FSA become, the more advisers have to charge to cover their compliance overheads, and now this will be out in the open, pressuring FSA to become a more efficient regulator

Further information:

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