# EXPLANATORY MEMORANDUM TO

# THE OCCUPATIONAL PENSION SCHEMES (CHARGES AND GOVERNANCE) (AMENDMENT) REGULATIONS (NORTHERN IRELAND) 2016

**S.R. 2016 No. 171**

## 1. Introduction

1.1 This Explanatory Memorandum has been prepared by the Department for Social Development to accompany the Statutory Rule (details above) which is laid before the Northern Ireland Assembly.

1.2 The Statutory Rule is made under sections 51(6) of, and paragraphs 1(1), (3) and (5) and 3(1) and (2) of Schedule 18 to, the Pensions Act (Northern Ireland) 2015 and is subject to the negative resolution procedure.

## 2. Purpose

2.1 These Regulations amend the Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015 ("the 2015 Regulations") to ban member-borne commission costs in relevant occupational pension schemes.

## 3. Background

3.1 The 2015 Regulations cover a range of measures aimed at controlling the level and range of charges in relevant schemes which are used by employers to meet their automatic enrolment duties (known as qualifying schemes).

3.2 These Regulations amend the 2015 Regulations to prohibit charges on members of qualifying schemes in respect of commission payments to advisers for certain advice or services. They will not apply to charges imposed under an agreement entered into before 6th April 2016 unless it is varied or renewed on or after that date.

3.3 The Regulations also require trustees to inform their service provider whether the scheme they are managing is being used as a qualifying scheme for automatic enrolment. They must provide this information within three months of whichever is the latest of: 6th April 2016, the date from which the scheme is used as a qualifying scheme for automatic enrolment, or the date on which the service provider becomes appointed as a service provider to the scheme.

3.4 In addition, the Regulations enable members to opt-in to receive advice and services provided to them, subject to certain conditions. These include that any such agreement must be set out in writing, including the cost of the advice or service and the duration over which the payment will be taken.

3.5 The Regulations also make technical amendments to the compliance provisions in Part 4 of the 2015 Regulations.

## 4. Consultation

4.1 There is no requirement to consult on these Regulations as they make in relation to Northern Ireland only provision corresponding to provision contained in regulations made by the Secretary of State for Work and Pensions in relation to Great Britain.

## 5. Equality Impact

5.1 Proposals for the Pensions Act (Northern Ireland) 2015 were subject to a full Equality Impact Assessment. In accordance with its duty under section 75 of the Northern Ireland Act 1998, the Department has conducted a screening exercise on the legislative proposals for these Regulations. They are technical and beneficial in nature and have little implication for any of the section 75 categories. The Department has concluded that they would not have significant implications for equality of opportunity and considers that an Equality Impact Assessment is not necessary.

## 6. Regulatory Impact

6.1 A Regulatory Impact Assessment is attached as an Annex to this Explanatory Memorandum.

## 7. Financial Implications

7.1 None for the Department.

## 8. Section 24 of the Northern Ireland Act 1998

8.1 The Department has considered section 24 of the Northern Ireland Act 1998 and is satisfied that these Regulations –

(a) are not incompatible with any of the Convention rights,

(b) are not incompatible with Community law,

(c) do not discriminate against a person or class of person on the ground of religious belief or political opinion, and

(d) do not modify an enactment in breach of section 7 of the Northern Ireland Act 1998.

## 9. EU Implications

9.1 Not applicable.

## 10. Parity or Replicatory Measure

10.1 The corresponding Great Britain Regulations are the Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2016 (S.I. 2016/304 which come into force on 6th April 2016. Parity of timing and substance is an integral part of the maintenance of single systems of social security, child support and pensions provided for in section 87 of the Northern Ireland Act 1998.

**ANNEX**

# REGULATORY IMPACT ASSESSMENT

## THE OCCUPATIONAL PENSION SCHEMES (CHARGES AND GOVERNANCE) (AMENDMENT) REGULATIONS (NORTHERN IRELAND) 2016

## BAN ON MEMBER-BORNE COMMISSION CHARGES IN QUALIFYING PENSION SCHEMES

The costs and savings outlined in this Regulatory Impact Assessment are calculated on a United Kingdom-wide basis.

### Background

1. Automatic enrolment began in 2012 for the largest employers and will be gradually rolled-out to medium, small and micro employers by 2017. It will generate an extra £11 billion a year in private pension savings[1] from around six to nine million people newly saving or saving more into a pension. To date 5.9 million eligible individuals have been automatically enrolled into a pension scheme. [2]

2. Automatic enrolment drives a fundamental shift in the dynamics of the workplace pensions market. The old model - whereby most individuals had to actively decide whether to join a pension scheme and the pensions industry had to spend time and money persuading them to do so – has gone. Instead employers have a legal duty to default their employees into a pension scheme and inertia keeps most of them there. This is leading to a huge increase in the numbers of workplace saving arrangements and funds flowing through the pensions industry. It is believed that this shift brings a new responsibility to ensure minimum standards apply in workplace schemes, including charging practices that are fair and appropriate for automatic enrolment. The creation of these minimum standards will help maintain confidence in automatic enrolment and the pensions industry that supports it.

3. To determine how best to create minimum standards that reflect these changed dynamics, the Department for Work and Pensions (DWP) in the summer of 2013 issued a Call for Evidence on minimum quality standards which asked for views on governance, scale, investment and administration standards. In October 2013 this was followed by a Consultation on Charges, which made proposals about protecting savers from high and unfair charges including a ban on member-borne commission charges in workplace pension schemes used for automatic enrolment. The Department for Social Development ("the Department") sought views from interested organisations in Northern Ireland on the consultation papers.

[1] Department for Work and Pensions (DWP), July 2012, *Workplace Pension Reform: digest of key analysis*
[2] The Pensions Regulator (TPR), Jan 2016, *Automatic Enrolment Registration Report* http://www.thepensionsregulator.gov.uk/docs/automatic-enrolment-monthly-registration-report.pdf

4. In 2013 the Office of Fair Trading (OFT) Defined Contribution (DC) market study[3] found, among its conclusions, that competition alone cannot be relied upon to drive value for money in the DC workplace pension market due to weaknesses in the buyer side of the market and the complexity of the product. The lack of transparency of scheme charges creates information asymmetry in the pensions market whereby the employer or scheme member often does not have the information or understanding of what is a good value scheme. Furthermore, there is a principal agent problem in the automatic enrolment market where the employer selects the scheme on behalf of their employees but may not understand or act in the employee's best interests. One specific feature of the existing market is commission arrangements agreed between a service provider and an adviser, or an employer and an adviser, where the charge is passed on to members who are required to pay for advice and services they do not use or may not benefit from.

5. The Better Workplace Pensions Paper (Cmd 8840) published in March 2014, responded to the recommendations made by OFT in their DC market study and the consultation on charges. It set out proposals to cap charges in default funds in qualifying schemes used to meet the employer duty and included proposals to ban member-borne commission charges in relevant workplace pension schemes used for automatic enrolment.

6. In October 2015 the DWP published the consultation **'Better Workplace Pensions: Banning member-borne commission in occupational pension schemes'** which sought views on the most effective means of banning commission by ensuring that requirements are placed on those firms that are best able to prevent and remove new and existing commission arrangements, without introducing unnecessary burdens on those firms who are not party to commission arrangements. The Department also sought views from interested organisations in Northern Ireland on the consultation paper.

**Problem under consideration**

7. Most individuals automatically enrolled will start saving into the default fund of defined-contribution workplace pension schemes. In the current market, financial advisers and service providers are able to agree commission arrangements where the financial adviser is remunerated for their services via an administration charge levied on all members of a pension scheme. The service provider administers the member charge, and members bear the cost.

8. There are three forms of commission arrangements:

- initial commission - this refers to an arrangement whereby a pension provider makes an up-front lump sum payment to an adviser in return for new business; the costs are recovered via a charge borne by scheme members;

- deferred commission - this refers to an arrangement whereby a pension provider agrees a lump sum payment with an adviser and makes the payments, for example, over 2-3 years once a scheme has been established; the costs are recovered via a charge borne by scheme members; and

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[3] Defined Contribution Workplace Pension Market Study', Office of Fair Trading, September 2013, http://webarchive.nationalarchives.gov.uk/20131101164215/http:/www.oft.gov.uk/shared_oft/market-studies/oft1505

- trail commission - this refers to an arrangement whereby on-going payments are borne by scheme members for advice or services provided by an adviser.

## Market failure – the case for intervention

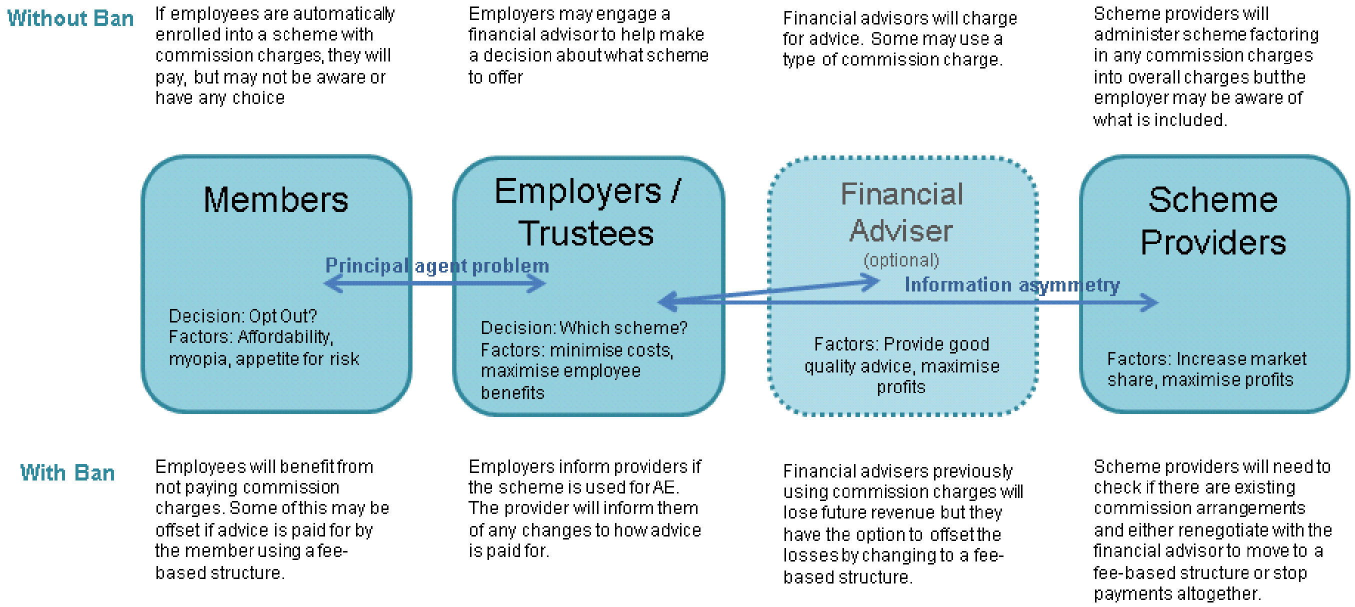
9. The 2013 OFT market study looked at the market for defined contribution workplace pension scheme provision and concluded that this market may not deliver value for money outcomes for scheme members. The report found that members could pay commission without realising; and that commission presented a barrier to employers switching their workers to better value for money schemes (because advisers may not recommend a change that would cut off their commission stream). There is a risk that as AE rolls out, the 9 million people who will be newly saving or saving more could be at risk of being enrolled, or are already enrolled, into schemes that include commission. There are two main structural weaknesses of this charging model:

   (a) **Principal-agent problem:** Scheme members rely on employers to select a workplace scheme into which they are enrolled and their respective interests and incentives are often different[4], and;

   (b) **Information asymmetry:** trustees who seek to maximise benefits for members may not be involved in the transactions that impose the commission fee and in many cases are not aware of the additional cost being borne by members or the benefits of moving to a scheme without commission.

10. The way in which the market currently works with commission in place and the scope of market failure is illustrated in Figure 1, along with the way in which the market will work following the introduction of the ban.

*Figure 1: commission process and expected outcomes following the ban*




[4] More information on the principal-agent problem can be found in the Charges in Qualifying Pension Schemes Impact Assessment, DWP, 2014: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/311363/pensions-act-ia-annex-g-charges-in-qualifying-pension-schemes.pdf

11. Since 2012 there have been a number of relevant interventions in the workplace pensions market, summarised by the figure below

*Figure 2: timeline of policy interventions*[5][6][7][8]

| | | | | |
|---|---|---|---|---|
| **Dec 2012**<br>The Financial Services Authority (FSA) introduce the Retail Distribution Review (RDR) banning new commission arrangements in personal pensions & group personal & stakeholder pension schemes.<br>The RDR brought about a shift in adviser remuneration from commission to fee-based arrangements | **Sep 2013**<br>OFT DC Pension Schemes Market Study concluded that competition alone could not be relied on to drive value for money for pension scheme members. In particular, members could pay commission without realising, and acted as a barrier to employers switching their works to better value schemes (because advisers may not recommend schemes that did not include commission. | **Oct 2013**<br>Government consultation on a range of measures to protect savers automatically enrolled into workplace pension schemes from possible detriment and support value for money. This included the proposal to ban commission in all schemes used for AE. | **Mar 2014**<br>Government announce commission ban for DC schemes for AE, as part of a range of measures to protect savers who had been automatically enrolled into a workplace pension<br><br>**Oct 2014, Feb 2015**<br>Command papers confirm intention to consult on most effective means of regulation, launched Oct 15. | ***Apr 2016***<br>*Introduce ban on new commission arrangements*<br><br>***Oct 2016***<br>*Introduce ban on existing commission arrangements* |

## Current market context

12. Evidence from the DWP Pension Charges Survey 2015[9] shows that commission is charged in a very small minority of trust-based pension schemes used for AE. Only two of twelve providers interviewed in the 2015 survey reported paying trail commission in trust-based schemes used for AE. These two providers confirmed that these arrangements related to only seven employers (just 1% of the 535 employers with single trust-based schemes used for AE covered by the survey).

13. This reflects the impact of the 2012 Retail Distribution Review (RDR) on the adviser market, which has subsequently moved from commission-based remuneration to fee-based remuneration. A survey of advisory firms conducted by FundsNetwork found that 80 of 89 firms polled believed that they were either 'somewhat' or 'very' confident that they will have moved all existing clients from commission to fee-based arrangements by April 2016; and 63% confirmed that they had already moved existing clients from

[5] Better Workplace Pensions: further measures for savers', DWP, 27 March 2014, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298436/better-workplace-pensions-march-2014.pdf
[6] 'Retail Distribution Review', Financial Conduct Authority, http://www.fca.org.uk/firms/firm-types/sole-advisors/rdr
[7] Defined Contribution Workplace Pension Market Study', Office of Fair Trading, September 2013, http://webarchive.nationalarchives.gov.uk/20131101164215/http:/www.oft.gov.uk/shared_oft/market-studies/oft1505
[8] 'Better Workplace Pensions: a consultation on charging', DWP, October 2013, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/254332/cm8737-pension-charges.pdf
[9] DWP Pension Charges Survey 2015: https://www.gov.uk/government/publications/pension-charges-survey-2015-charges-in-defined-contribution-pension-schemes

commission to fee-based arrangements. Although this survey was conducted in relation to rules made by the Financial Conduct Authority (as opposed to the proposed DWP regulations) this demonstrates that advisers have or are already transitioning to fee-based arrangements.

14. This is important as the Government intends to ban commission while enabling advisers to receive payment via a fixed-fee. This is also reflected in responses received from industry stakeholders following the Government's consultation on banning commission in occupational pension schemes used for AE. For example, some of the advisers spoken to confirmed that they already wholly operated on a fee-basis; others advised that they had already begun to transition from commission to fee based arrangements following the RDR and the announcement of FCA rules (which will come into effect from April 2016).

**Policy objective**

15. The policy objective is to prevent members of occupational schemes used for AE from being charged for commission arrangements agreed between third parties, and paying for advice and services they do not use or benefit from. This will support automatic enrolment and maintain trust and confidence in pension saving. Advisers will still be able to offer and charge via a fee for specific advice and services to members and employers - but they will no longer be paid for this via a blanket charge on all members within schemes.

**Description of options considered**

16. Four policy options have been considered:

    1) do nothing;

    2) place a duty on trustees requiring them to ensure that members of pension schemes they are managing are not bearing the costs of commission;

    3) place a duty on service providers requiring them to prevent and remove new and existing commission arrangements; or

    4) place a duty on both trustees and service providers.

17. The risk that the 9 million members who will be newly saving or saving more as a result of automatic enrolment have the value of their savings eroded by hidden commission charges is too high to do nothing.

18. Following consultation, the Government's preferred approach is option 4, which places requirements on both trustees and service providers. This is because service providers are best placed to prevent commission; but the provider and the trustee hold different pieces of information which need to be shared in order for the ban to be effective. Under option 2 service providers may not know which schemes relate to automatic enrolment, and under option 3 trustees may not know whether the scheme contains commission.

Alternatives to regulation have not been considered, given that previous non-legislative approaches have had limited effect.

## Preferred option

19. The preferred approach is option 4 which places duties on both trustees and service providers. The analysis for this impact assessment estimates the cost and benefits of this preferred option against the counterfactual (do nothing).

20. As part of the compliance and enforcement process, trustees will also have to confirm in their scheme return that members are not paying for commission. The scheme return is an existing process managed by The Pensions Regulator (TPR). Trustees are already obliged to confirm adherence to other charges control measures, including the charge cap, via the scheme return.

21. The intention is to implement the ban in two stages:

- from April 2016 – a ban on new commission arrangements; and
- from October 2016 – a ban on existing commission arrangements.

22. A phased implementation of the ban will help to ensure that workers of employers who will be staging as a result of AE from April 2016 onwards will be protected by the ban on new arrangements; while providing additional time for the Government to prepare and consult on regulations for banning existing commission arrangements, given the complexities involved in this.

23. DWP has consulted on draft regulations banning new commission arrangements in early 2016, to be followed by a consultation on draft regulations banning existing commission arrangements later in 2016. This impact assessment quantifies the costs and benefits of both stages of the ban.

## Evidence sources

24. The main sources of available evidence on the prevalence of member-borne commission arrangements are the DWP Landscape and Charges Survey 2013 and the DWP Pension Charges Survey 2015.

25. In the 2013 survey, employers reported commission arrangements (grouping together all types of commission) for 25% of their defined contribution trust-based schemes. However, there was substantial variation in the reported prevalence of commission arrangements according to scheme age (33% for schemes established prior to 1991, 19% for those established from 2001 onwards) and charge level (35% for those with average annual charges above 0.75%, 14% for those with average annual charges at or below 0.75%).

26. The 2013 survey did not distinguish between schemes used for AE and those not used for AE, since only the largest employers had started staging into AE at the time of survey in April-May 2013. However, the survey evidence suggests that those schemes with

commission arrangements present were older and higher charging schemes, which would be less likely to qualify for use as AE schemes as employers began their staging.

27. This is supported by evidence from the more recent DWP Pension Charges Survey 2015, which does distinguish between whether or not schemes are being used for AE. The 2015 survey interviewed 12 providers of pension schemes, including 8 of the top 10 based on market share. Since providers are directly involved in commission arrangements, they are better placed to report on prevalence than the employers interviewed in the 2013 charges survey.

28. Providers in the 2015 survey reported no initial/deferred commission via member contribution charges in trust-based schemes used for AE, covering approximately 4.5 million members across master-trust and single trust-based schemes. For these same schemes, trail commission was reported by two of eight providers with single trust-based schemes used for AE (and by none of the nine providers who had master-trusts used for AE). The two providers reporting trail commission estimated that this related to only 7 employers in total (1% of the 535 employers with single trust-based schemes used for AE captured by the survey).

29. To inform the assessment of the costs and benefits to business of the preferred option, evidence from the following sources has been used:

- The 2015 and 2013 charges surveys set out above;
- Estimates requested from the 2015 charges survey research contractor on the number of members subject to commission charges based on survey responses and qualitative interviews;
- Estimates requested from The Pensions Regulator (TPR) on the numbers of service providers affected by the ban, and published TPR estimates on the number of trust-based schemes used for AE; and
- Previous DWP impact assessments, consulted to ensure consistency in approach.

30. Based on the evidence set out above DWP calculated an initial assessment of the costs and benefits of the ban, and then used the consultation to gather further evidence. DWP included a question in the consultation document on the potential impacts of the ban for all affected parties; held roundtable and one-to-one sessions with stakeholders representing the different parties affected by the ban; and, explicitly tested assumptions and initial estimates with a number of providers.

31. The evidence gathered during the consultation suggests that:

- The estimated number of members subject to commission charges, due to existing arrangements, in occupational schemes used for AE is approximately 20,000 members.
- The average level of commission charge is equivalent to around 0.18% of funds under management. This is a weighted average based on information supplied during

the consultation from providers who set out the number of their members subject to different commission charge levels.

32. The above evidence has been used to estimate the potential costs and benefits of the preferred option, and it is considered that it would not be proportionate to commission further research on this topic.

**Direct costs and benefits**

33. Three types of direct costs and benefits associated with the preferred option are discussed:

- Familiarisation costs;

- Costs and benefits of the April 2016 ban on new commission arrangements; and

- Costs and benefits of the October 2016 ban on existing commission arrangements.

34. These are set out for each of the following parties affected by the commission ban: service providers[10], trustees, financial advisers, employers and members.

35. The estimates presented here are in 2015 price terms throughout, with the hourly rates data taken from the most recent available 2015 Annual Survey of Hours and Earnings (ASHE)[11].

**Familiarisation costs**

36. It is expected that there will be one-off familiarisation costs for service providers and trustees due to the regulatory duties being placed on them, and for financial advisers who are servicing this part of the market and who will no longer be remunerated via commission arrangements.

37. The majority of these costs were incurred in the previous parliament. DWP announced the forthcoming commission ban in March 2014[12] as part of a package of measures that would be introduced in a phased approach from 6 April 2015 onwards. The commission ban was planned for April 2016 to allow providers and advisers time to prepare for the ban. DWP re-iterated details of the commission ban in follow-up documents of October 2014[13] and February 2015[14]. Further to this, many of the service providers will be the

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[10] On the basis of the responses to recent consultation, it was decided to exclude approximately 200 investment manager firms from the regulations, since investment managers would generally not be able to facilitate the provision of advice and services to members (there are members of the Investment Association).

[11] Published 18 November 2015 and available at: http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/index.html

[12] DWP Better workplace pensions: Further measures for savers. March 2014

[13] DWP Better workplace pensions: Putting savers' interests first. October 2014. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/364567/better-workplace-pensions-putting-savers-interests-first.pdf

[14] DWP Government response to the consultation on Better workplace pensions: Putting savers' interest first. February 2015. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/400864/better-workplace-pensions-putting-savers-interests-first-response.pdf

same parties who are affected by the FCA commission ban[15] for qualifying personal pension schemes, which also comes into effect in April 2016.

38. Both DWP and FCA have consulted on the forthcoming ban, and there is widespread industry awareness with many providers having publicly announced their strategy of preparing for the ban. As just one example, Royal London publicly set out changes they would be making in anticipation of the ban in November 2014 with subsequent follow-up communications in February 2015 and March 2015[16]. DWP have engaged with stakeholders throughout the industry prior to and during the consultation. Providers and advisers confirmed during consultation, and providers reported in the DWP Pension Charges Survey 2015, that they are aware of, and have been making preparations for, the ban. It is expected that trustees or managers of AE schemes will be aware of the forthcoming ban as it forms part of the wider package of charges measures that they should be aware of as part of their responsibilities in managing their schemes

39. Since awareness of the commission ban is widespread throughout industry, it is expected that the familiarisation costs incurred in this parliament will be only those relating to the specific details on the timing and nature of the implementation of the ban, as announced following the consultation. This will involve reading and digesting the consultation response document of approximately 40 pages. Following the approach of the private sector defined benefits transfers IA[17], it is estimated it will take 100 minutes to read 40 pages (based on an average reading speed of 300 words per minute) and allow a further 20 minutes to digest the information. This gives a total of two hours work for familiarisation, which will be incurred by all service providers, trustees and financial advisers.

*Familiarisation costs – service providers*

40. The estimated total number of affected service providers is as follows: 50 administrators for trust-based schemes used for AE and 30 insurers for trust-based schemes used for AE[18]. This gives a total of 80 service providers who are expected to incur any familiarisation costs[19].

41. The total costs of familiarisation for service providers is estimated to be £3,962 based on two hours work at a median hourly rate of £24.77 (including any non-wage costs)[20] for one professional, across 80 providers. This represents a maximum estimate for service providers as in many cases this responsibility will be delegated to their legal advisers who are already paid for ongoing services.

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[15] FCA Final rules for charges in workplace personal pension schemes and feedback on CP14/24. March 2015. https://www.fca.org.uk/your-fca/documents/policy-statements/ps15-05

[16] 'Our charge cap and commission stance', Royal London, 2014, http://adviser.royallondon.com/articles/updates/2014/november/our-charge-cap-and-commission-stance/

[17] Amendments to Pension Schemes Bill (private sector defined benefit transfers) IA. IA no: RPC14-HMT-2212. September 2014. http://www.parliament.uk/documents/impact-assessments/IA14-13A.pdf

[18] Estimates of insurers and administrators for trust-based AE schemes provided by The Pensions Regulator (TPR).

[19] This represents a maximum estimate of affected service providers because there could be double-counting of the service providers in the case of bundled schemes.

[20] The estimate of £24.77 is based on the gross median hourly rate for a professional, increased by 27% in line with the Green Book to account for non-wage costs. It is assumed that for both administrators and insurers a single professional employee would undertake this work. The hourly rate data are taken from the Annual Survey of Hours and Earnings (ASHE), 2015: http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip.

*Familiarisation costs - trustees*

42. The estimated number of trustees incurring familiarisation costs is 910, based on one trustee for each of the 910 DC trust-based schemes and hybrid schemes used for AE[21] needing to familiarise. The total familiarisation costs for trustees is estimated to be £34,748 based on two hours work for an associate professional at a median hourly rate of £19.10 (including any non-wage costs)[22], across 910 schemes. The hourly rate assumed for a trustee is at the associate professional level, in line with the private sector DB transfers IA[23]. In practice, many trustees are unpaid whilst some may receive higher wages than this, with this figure representing the best estimate of the average trustee hourly rate.

*Familiarisation costs – financial advisers*

43. There is no estimate of the number of financial advisers who have commission arrangements in qualifying, trust-based schemes, although the evidence from the Pension Charges Survey 2015 has shown that such arrangements are uncommon. A simplifying assumption is made in estimating that there is one financial adviser for each of the 910 qualifying, DC trust-based and hybrid schemes. This will be an overestimate, as the pensions advice market is more concentrated than this with many schemes receiving advice from the same adviser, rather than there being one distinct adviser per scheme. However, without further evidence, this remains the best estimate, producing estimated costs of familiarisation to financial advisers of £45,052 based on two hours work for a professional at a median hourly rate of £24.77 (including non-wage costs)[24] across 910 financial advisers.

*Total combined familiarisation costs*

44. This gives a total combined (for service providers, trustees and financial advisers) estimate of one-off familiarisation costs of approximately £85,000.

**Costs and benefits of the April 2016 ban on new arrangements**

*Service providers*

45. After accounting for the familiarisation costs set out above, it is estimated that the ban on new commission arrangements will have **zero ongoing costs** for service providers. Where service providers have previously relied on advisers to promote their services, and paid for this via member-borne commission, they will need to find alternative ways of promoting the scheme and paying for this service. However, based on the evidence set out in paragraphs 24-28, commission is largely a legacy issue rather than a model that service providers rely on to achieve business in the current AE market. AE has

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[21] The number of DC trust-based and hybrid schemes used for AE is taken from Table 5 of TPR's Automatic Enrolment Commentary and Analysis, 2015 http://www.thepensionsregulator.gov.uk/doc-library/research-analysis.aspx#s16194. The number stated here is higher than that shown in Table 5 because we have apportioned the unknown responses between scheme types. This may be a slight over-estimate as not all hybrid schemes have money-purchase benefits associated with them. We do not expect this estimate to alter significantly in the lead up to the ban in 2016, as the majority of employers automatically enrolling between now and then are likely to use already established schemes.

[22] The estimate of £18.87 is based on the gross median hourly rate for an associate professional, which is increased by 27% in line with the Green Book to account for non-wage costs. The hourly rate data are taken from ASHE, 2014: http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2014-revised-results/rft-2.zip Table 2.5a.

[23] Amendments to Pension Schemes Bill (private sector defined benefit transfers) IA. IA no: RPC14-HMT-2212. September 2014. http://www.parliament.uk/documents/impact-assessments/IA14-13A.pdf

[24] The estimate of £24.77 is based on the gross median hourly rate for a professional, increased by 27% in line with the Green Book to account for non-wage costs. The hourly rate data are taken from the Annual Survey of Hours and Earnings (ASHE), 2015: http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip

substantially reduced the reliance on intermediaries for new business, with employers now going direct to service providers.

46. As service providers simply make commission payments to advisers (and recover the cost from member charges), rather than retaining them, they should be financially no worse off as a result of being prevented from facilitating these payments in future.

*Trustees*

47. There will be **zero ongoing costs** to trustees of the ban on new commission arrangements. Trustees are already required under governance regulations to consider whether the costs and charges borne by members represent good value. It should not impose any additional burdens on trustees to confirm that their schemes are commission free via the annual scheme return, which already forms part of their duties. Further, confirming to service providers whether or not the scheme is being used for AE, should be a straightforward process for trustees as they will know this information and could confirm this electronically.

48. It is not expected there will be any issues of non-compliance on the part of service providers for trustees to respond to since: providers do not gain from setting up commission arrangements; evidence suggests that such arrangements are already uncommon; and, not having commission arrangements allows providers to more easily ensure they meet the 0.75% default fund charge cap and retain the significant business they receive from AE.

49. Under the ban on new arrangements, trustees, like employers and members, will still be able to access advice and services provided by an adviser. Any costs and charges will be borne by the trust as before.

*Financial advisers*

50. The ban on new arrangements will have a **minimal cost loss of revenue** for financial advisers. Advisers will still be able to offer and provide the same services, but will need to be remunerated on a fee-basis rather than through commission.

51. Advisers are well positioned to offer services based on alternative payment models, other than commission. Following the RDR, which came into effect on 31st December 2012, advisers had to set up new fee-based charging structures. It is expected that these will be the same advisers affected by the forthcoming commission ban, because financial advisers would advise on different types of pension schemes across the pensions market. Further, the evidence set out above suggests that this direction of travel to fee-based charging structures has continued.

52. Whilst financial advisers will largely be able to respond to the ban on new arrangements with alternative fee-based structures if they wish to, this part of the ban will have minimal cost impact because the evidence suggests that new commission arrangements are rarely used in the specific part of the market affected by this ban, e.g. trust-based schemes used for AE. Providers in the 2015 charges survey did not report any initial/deferred commission arrangements (i.e. those more recently set up) for their trust-based AE schemes. There is a possibility that employers or members may be less likely to take advice if they face upfront costs as opposed to commission arrangements, but

there is no evidence available to quantify this risk. In the broader context, the introduction of automatic enrolment is likely to increase demand for advice.

53. Through engagement with financial advisers, it is understood that commission related revenue is a small and declining stream of revenue. During the consultation, one adviser body suggested that advisers have been moving away from this type of commission business, in favour of the greater and more profitable business available to them generated by the pension flexibilities introduced in April 2015. The potentially more costly impact for advisers would be due to the October 2016 part of the ban on existing commission arrangements.

54. Given that it is considered so few advisers may incur a cost from the ban on setting up new commission arrangements, no attempt was made to estimate this cost.

*Employers*

55. Employers who wish to seek advice from 6 April 2016 onwards will need to cover the cost. This may affect small and micro employers who have not yet automatically enrolled their employees at the commencement date. Where employers already have a scheme they can use, they will not need to seek advice. For employers who do not have a scheme, NEST offers a low-charge option into which they can enrol their employees without seeking advice. Other low charge schemes that do not involve any employer costs are also available and widely promoted within the market. Therefore, it is expected that employers will only seek advice where they feel the benefits outweigh the costs and it is in their interest to do so. Since it is optional whether employers seek advice, this is estimated to be a **zero cost** impact. It is not necessary for employers to pay for advice to implement AE.

*Members*

56. Members will gain from the April 2016 ban by not having to pay for services they may not be in receipt of, and only paying for such services where they explicitly seek to do so.

**Costs and benefits of the October 2016 ban on existing arrangements**

*Service providers*

57. It is estimated there will be a one-off administrative cost to service providers of stopping any existing deferred or trail commission arrangements. This cost will vary between different firms depending on factors such as the complexity of the systems that need updating.

    This one-off administrative cost will entail:

    - step 1: the service providers identifying which of their schemes currently contain commission arrangements;

    - step 2: communicating with advisers to inform them of the relevant arrangements affected by the ban and either (a) setting up a new non-commission payment arrangement where members can opt-in to advice or services; or (b) stopping the payments altogether;

- step 3: updating systems to implement the ban; and

- step 4: confirming to the trustee that the commission arrangement has been removed.

58. Providers should already be aware of whether they are or are not paying commission in respect of the schemes they run, so the introduction of the ban should not lead to any additional cost with regard to step 1. Providers confirmed in the DWP Pension Charges Survey 2015 and during consultation that they are aware of whether or not they have commission arrangements.

59. The costs of steps 2 to 4 will vary depending on factors such as the number of schemes run by that provider which commission is being removed from and the age of the schemes. At the lowest end, we estimate this to take one week (approximately 40 person hours), for an associate professional at a rate of £19.10 per hour (including any non-wage costs)[25]. This totals a cost of £764.00 per service provider affected by the commission ban. Where there are a larger number of schemes to discuss, a variety of advisers in receipt of commission, or a greater complexity of commission to unpick and more systems to update, these costs will be higher. For example, if it is assumed that a professional would be doing this work, rather than a pensions administrator, at a median hourly rate of £24.77 (including any non-wage costs)[26] and that this work may take up to 4 weeks (160 hours) a maximum estimate of £3,962.40 per service provider is obtained.

60. The estimated total number of affected service providers is as follows: 50 administrators for trust-based schemes used for AE and 30 insurers for trust-based schemes used for AE[27]. The Pension Charges Survey 2015 found that 2 of 8 providers of qualifying trust-based schemes had any commission arrangements. This gives an estimate of 25% of service providers who may need to incur this one-off administrative cost[28]. This means out of a total of 80 service providers, it is expected that 20 will incur this one-off administrative cost of stopping existing commission arrangements.

61. The estimated number of affected service providers can be multiplied by the minimum estimated cost for each service provider of £764.00, to give a lower estimate of a one-off administrative cost of £15,281. When multiplying the number of service providers by the maximum estimated cost for each service provider of £3,962.40, it is estimated that a higher one-off administrative cost of £79,248 results. Since, it is expected that the commission ban will be more onerous for some of the affected providers than for others, depending on the number of schemes and number of commission arrangements they have, an average between these two costs has been used to reach a best estimate of the total one-off administrative cost to service providers of £45,000.

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[25] This estimate is based on the assumption that pension's administration is likely to be a higher wage paying profession than general administration. The hourly rate data are taken from ASHE, 2015 http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip. The estimated time taken to implement the changes is based on discussions with a range of providers during the consultation.

[26] ASHE, 2015: http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip.

[27] Estimates of insurers and administrators for trust-based AE schemes provided by The Pensions Regulator.

[28] The Pension Charges Survey 2015 related only to insurers but since there is no further information available, the assumption is made that this estimate also applies to other service providers affected by the ban. It is known from the 2015 survey that the prevalence of commission for trust-based schemes used for AE is low, so 25% affected is likely to be a reasonable assumption.

62. It is not envisaged there will be any additional impacts on service providers, above this one-off administrative cost, as they are simply facilitators of member-borne payments to advisers in the case of deferred and trail commission. Service providers will also be allowed to recoup any money from members' funds that they have already paid up-front to advisers for initial commission, so will not lose any monies outlaid.

63. Some service providers indicated in October 2013 and during the recent consultation that the ban on commission arrangements will help them to meet the 0.75% charge cap on member charges introduced in April 2015.

*Trustees*

64. In the case of trustees, it is believed that the impacts of the October 2016 ban on existing arrangements will be part of the same process as for the April 2016 ban on new arrangements set out above as a **zero cost** impact.

65. Trustees will continue to be able to access advice and services. Any costs and charges will continue to be borne by the trust.

*Financial advisors*

66. Financial advisers may be impacted by the future loss or reduction in recurring income streams they receive from existing commission arrangements, although advisers will not be required to re-pay any commission they have received prior to the commencement of the ban.

67. To estimate the potential impact of the ban on existing arrangements to financial advisers, the same modelling approach has been adopted as used in the Charges in Qualifying Pension Schemes IA[29]. Here the model used is the difference in pot sizes over ten years from the commencement of the ban in 2016 for a member with, and without, commission in their annual charge.

68. The modelling is based on a median earner in the automatically enrolled population who did not previously have a workplace pension until 2013, and who is estimated to earn around £20,000 in 2013[30] [31]. The average annual charge for the individual without commission is set at 0.46% (based on the qualifying, trust-based average annual charge from the Pension Charges Survey 2015) and, for the individual with commission, this is set at 0.64% (based on the 0.18% weighted average charge of commission members in trust-based schemes used for AE are subject to as described in paragraph 31). The average difference in pot size over the ten year period is estimated at £58 per member, per year. This can be viewed as the average loss to the adviser industry per year, for each member who is subject to commission arrangements.

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[29] Charges in qualifying pension schemes. February 2014. DWP IA No: DWP0042. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298302/ia-charges-qualifying-pension-schemes-feb-2014.pdf

[30] Department for Work and Pensions (DWP), July 2013, *Supporting automatic enrolment: further analysis of earnings, participation and provision,* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209864/ad-hoc-supporting-ae-further-analysis.pdf

[31] Modelling is based on a median earner, earning £20,000 a year, with contributions at 2% for the first five years, 4% for the sixth year, 7% for the seventh year and 8% thereafter - in line with automatic enrolment requirements. Inflation is set at 2%, earnings growth is 4.5% and investment growth is 7%.

69. The best estimate of the number of members subject to commission arrangements in qualifying, trust-based schemes is approximately 20,000 members. At £58 per member, this gives an estimate of approximately £1.16m per year potential aggregate loss to the adviser industry.

70. This is a maximum estimate of the actual loss to the industry because this estimate assumes no advisers will re-negotiate their existing contracts to switch to fee-based payment models, whereas industry evidence suggests that some advisers will make this switch. Further, adviser bodies advised during the consultation that some adviser firms are being set up to take on this business where other advisers choose not to re-negotiate their existing contracts. This would result in a transfer between adviser businesses, rather than a net loss. However, since there is no information to indicate how much business will be re-negotiated or transferred, no estimate has been made of any mitigated losses.

*Employers*

71. Employers who have previously sought advice paid for via commission arrangements will not be affected by the October 2016 ban as this arrangement now exists between providers and advisers for whom the costs and benefits are discussed in the relevant sections.

*Members*

72. As with the ban on new arrangements, members will benefit from the ban on existing commission arrangements by no longer having to pay for services they may not have been in receipt of, and only paying for such services when they elect to do.

73. All else being equal, members will see an increase in the value of their pension pot at retirement if providers reduce their charges after removing any commission payments. Since it is not known to what extent providers will reduce charges and to what extent advisers may re-negotiate their existing contracts, it is only possible to make a simplifying assumption and produce a maximum estimate. The estimate is made on the basis that providers would reduce members charges by the total amount they were paying due to commission, meaning that the benefit to members would be equal to the loss of income to providers, at approximately £1.16m per year across all members.

**Summary of costs and benefits**

74. Table 1 summarises the estimated costs and benefits set out above.

**Table 1:** *summary of estimated costs and benefits of the commission ban*

| **Parties affected by the ban** | Familiarisation | April 2016 ban on new arrangements | October 2016 ban on existing arrangements |
|---|---|---|---|
| Service providers | **£4000** (one off costs) | **Zero** | **£0.05m** (one-off *costs*) |
| Trustees | **£0.03m** (one-off *costs*) | **Zero** | **Zero** |
| Financial advisers | **£0.05m** (one-off *costs*) | **Minimal** (*costs* not quantified) | **£1.16m** (ongoing, annual *costs*) |
| Employers | **n/a** | **Zero** | **Zero** |
| Members | **n/a** | **Zero** | **£1.16m** (ongoing, annual *benefits*) |

75. Under the preferred option there is a direct impact on service providers, trustees and financial advisers. All costs are calculated in 2015/16 prices. Total costs to business are estimated as: (1) a one-off combined familiarisation cost for service providers, trustees and financial advisers of £0.08m; (2) a one-off administrative cost to service providers for removing existing commission of £0.05m; and, a maximum ongoing annual cost to financial advisers for lost income of £1.16m.

**Other Impacts**

Equality

76. Proposals for the Pensions Act (Northern Ireland) 2015 were subject to a full Equality Impact Assessment and the regulations are in consequence of the Act. In accordance with its duty under section 75 of the Northern Ireland Act 1998, the Department has conducted a screening exercise on the proposals for the regulations and considers that the regulations do not have any additional implication for equality of opportunity.

Environmental

77. There are no implications.

Rural proofing

78. There are no implications.

Health

79. There are no implications.

Human rights

80. The Department considers that the regulations are compliant with the Human Rights Act 1998.

Competition

81. There are no implications.

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed for the Department for Social Development

Anne McCleary

Anne McCleary
Director of Social Security Policy and Legislation

15 February 2016

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