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THE OCCUPATIONAL PENSION SCHEMES (CHARGES AND GOVERNANCE) (AMENDMENT) REGULATIONS (NORTHERN IRELAND) 2022

REGULATORY IMPACT ASSESSMENT

INVESTOR IN PEOPLE

REGULATORY IMPACT ASSESSMENT

The Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations (Northern Ireland) 2022

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

Evidence Base

The policy background

The Charge Cap

1. In 2015, the charge cap on all member-borne charges[1] was introduced. The charge cap applies solely to the default fund of defined contribution (DC) schemes used for automatic enrolment. It covers all member-borne administration charges associated with scheme and investment administration excluding transaction costs and a small number of other specific costs and charges. This was designed to protect members from unfair charges, deliver value for money and improve transparency of costs and charges.

2. The charge cap is set at 0.75% and there are three permitted charges structures:

   a) a single percentage charge, capped at 0.75 per cent of funds under management annually;

   b) a combination of a percentage charge for new funds when they are contributed to the pot plus an annual percentage charge for funds under management;

   c) a combination of an annual or monthly flat fee plus an annual percentage of funds under management charge.

3. The Pensions Regulator[2] (TPR) estimates that over 20 million members are in occupational DC schemes used for automatic enrolment and have therefore benefited from the introduction of the charge cap.

Flat Fee Charges

4. Different charging structures affect pension pots in different ways. There is evidence from the Pensions Policy Institute that flat fees, whether alone or in combination with other ongoing charges, erode pots quicker than other charging structures (as seen in Table 1). This can have a significant impact on deferred pension pots in particular, which can be eroded to zero within a number of years. Small active pension pots can also be impacted by flat fees. Unlike deferred pension pots where there are no on-going contributions, an active

[1] The Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015 https://iaccess.communities-ni.gov.uk/sspldbluevolumesinternet/users/internetsearchpage.aspx

[2] https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2019-2020

pension pot may still grow due to member and employer contributions, but a flat fee may take away a large proportion of any growth for small pension pots.

Table 1: The Pensions Policy Institute modelling of different charging structures on deferred pot sizes

Charging structure	Pot size at age 68					
	Deferred at age 22			Deferred at age 40		
	£100	**£500**	**£1,000**	**£100**	**£500**	**£1,000**
Baseline – no charge	£300	£1,500	£3,000	£200	£1,000	£1,900
0.5% AMC only	£200	£1,200	£2,400	£200	£800	£1,700
£20 annual flat fee and 0.25% AMC	£0	£100	£1,400	£0	£200	£1,100
£24 annual flat fee only	£0	£0	£1,400	£0	£100	£1,100

Source: The Pensions Policy Institute[3]

5. The impacts of flat fees on pension pots will vary depending on the size of the flat fee, the rate of investment growth, the level of member and employer contributions, and the size of the pension pot.

6. Within the DC pension industry, small pension pots affect both pension providers and members. For providers, the cost of servicing small pots can be in excess of the pot-level revenue generated by just a percentage charge. For members there is a risk their small pot can be eroded by charges, especially if the member is no longer paying into the pot. For members with more than one small pension pot, it could be possible that they could be subject to multiple pot erosion across different providers. This is a risk for the reputation of the pension industry and workplace pension saving if members see their pots depleted entirely and lose confidence in pension saving.

7. The DC pensions market is still relatively immature and some providers are still in the process of repaying start up loans. The Pensions Policy Institute's report on Master Trust sustainability[4] found the greatest challenge to the financial sustainability of master trusts is the need to cover initial start-up and running costs until levels of membership and assets have grown sufficiently. Therefore these providers must balance delivering value for money for their members and their financial sustainability going forward.

8. Evidence from the Charges Survey 2020[5] indicates that on average, the fees charged to members are low and that this is due to competition in the market. Setting the de minimis too high could reduce competition in the future, worsening outcomes for members on average.

Rationale for Intervention

9. It is recognised that it is important to ensure that individuals who are automatically enrolled into a workplace pension scheme are protected from high and unfair charges and are saving into schemes that are well governed. This includes ensuring pension scheme members get value for money from their workplace pensions.

[3] https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf
[4] https://www.pensionspolicyinstitute.org.uk/media/3590/20200827-ppi-financial-sustainability-of-master-trust-schemes-final.pdf
[5] https://www.gov.uk/government/publications/pension-charges-survey-2020-charges-in-defined-contribution-pension-schemes/pensioncharges-survey-2020-charges-in-defined-contribution-pension-schemes

10. The combination charge, levying both a percentage charge and a flat rate fee, is of concern because flat fees can continue to be levied on a pot irrespective of whether a member is continuing to make contributions. This of particular concern for individuals who have one or more small pension pot.

11. As noted in the Small Pots Working Group report[6], making workplace pension saving the norm, especially for people who move jobs frequently, created an increased risk that an individual's pension savings could become fragmented into a number of deferred, small pension pots. In 2012, it was estimated[7] that employees work for 11 employers on average during their working life (with a quarter working for more than 14 employers). More recent estimates from external research studies[8] suggest that people aged 18 - 34 may expect to have an average of over 12 jobs in their lifetimes. The ONS[9] estimate that around nine per cent of people changed jobs each year between 2000 and 2018 on average, reaching a high of 10.9 per cent in 2018, further demonstrating the extent of churn in the labour market. Whilst in some cases new employees may be automatically enrolled into schemes where they already have an existing pot, the estimated frequency of job moves combined with the large number of providers in the DC market (from which employers are free to choose) makes the accrual of several small pots through changing jobs a likely reality for many savers.

12. Without further intervention, flat fees would continue to be charged on smaller pension pots and risk these being eroded further. In the worst cases, this may lead to some pots being eroded to zero and without intervention, these people with small pension pots would continue to see their pots eroded which negatively impacts their future income as a pensioner.

13. Building on this, there is an equity argument for intervening to protect those with pots £100 or below. Those with multiple small, often deferred pots, are more likely to be those on low incomes and in more precarious forms of work. There is a body of evidence, such as that published by the Institute for Social and Economic Research[10] (ISER) and Joseph Roundtree Foundation[11] (JRF) that explores the relationship between low pay and labour market churn, suggesting that those with higher numbers of small, deferred pension pots are more likely to be lower earners. For example, the JRF report on low pay found one aspect of low-paid work that is particularly concerning is its link to employment insecurity. Those working for low wages tend to also be working in jobs characterised by temporary contracts and low hours.

14. Analysis of the Wealth and Assets Survey[12] supports this, suggesting that small, retained pots are found in highest numbers amongst females, those of lower earnings, and younger individuals. Flat fees placed on lower earners will be regressive and the introduction of a de minimis will therefore provide some protection against this.

15. As well as deferred pension pots, small active pension pots may see some or all of their growth eroded by flat fees.

16. To assess the impact of the de minimis the following sources of evidence have been used:

- the Pension Charges Survey 2020;

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[6] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945319/small-pots-working-groupreport.pdf

[7] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/184965/small-pots-automatic-transfersimpact-assessment.pdf

[8] https://www.recruitment-international.co.uk/blog/2017/11/millennials-likely-to-have-12-jobs-in-their-working-lives-research-finds

[9] https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/compendium/economicreview/april2019/analysisofjobchangersandstaye

[10] https://www.iser.essex.ac.uk/research/publications/523273

[11] https://www.jrf.org.uk/sites/default/files/jrf/migrated/files/unemployment-pay-poverty-full.pdf

[12] https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/debt/methodologies/wealthandassetssurveyqmi

- Wealth and Assets Survey;
- data from the Small Pots Working Group;
- analysis from the Pensions Policy Institute; and
- engagement with the industry.

Description of options considered

Policy Option 0: Do nothing

17. Consideration has been given to the option of not introducing regulations to limit the application of flat fees on pots of £100 or less. However, there are several reasons why the 'Do Nothing' option is not preferred.

18. If no de minimis is introduced some pension pots subject to flat fees will continue to be eroded. Whilst this would require no new regulations, and pension schemes would not have to make any changes to their charging structures or governance, it does not prevent pots from being gradually eroded or fully charged out.

19. The charge cap introduced through the Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015 provides a level of protection to members and prevents a range of unfair charging structures. However, there is evidence of member's pots being eroded despite the charge cap. For example there was a view that flat fee charges could lead to pension scheme members being in a position where they can lose all of their pension savings.

20. There would be no cost to business through this option although there would also be no benefit for members.

Policy Option 1: Introducing a £100 de minimis (preferred) on flat fees

21. Introducing secondary legislation to implement a de minimis pot size below which flat fees cannot be charged in default fund schemes. All other ongoing fees and charges continue to be applicable to these pots. It is believed that a £100 de minimis strikes the right balance between tackling the issue of pot erosion for pension scheme members, whilst at the same time enabling the newer master trust pension schemes to maintain financial sustainability over the short term as their membership builds up and generates increasing revenue.

Policy Option 2: Introduce guidance around the erosion of smaller pots by flat fees

22. Consideration has also been given to a less comprehensive non-mandatory policy option; issuing further guidance to schemes on how to take into account whether their members are at risk of pot erosion by flat fee charges.

23. This option would not confer any new responsibilities or duties on occupational pension schemes. Instead the guidance would be published by the Department with the objective of encouraging schemes to consider the impact of flat fees on small pension pots.

24. However, the lack of statutory weight behind the guidance would be unlikely to result in the level of compliance and implementation that the policy objective requires. There would be no obligation for providers who levy flat fees to follow this guidance so some members would still see their pots eroded to zero. An example of this, as referenced in a previous Impact

Assessment[13], is non-statutory guidance from TPR in the Defined Benefit Funding Code of Practice. TPR research found that 92% of trustees interviewed stated they had read the DB code of practice or a summary of it provided by the adviser. However, only 64% of trustees stated they had carried out all five of the activities.

25. It is estimated that the only cost to business for Option 2 to be one-off familiarisation with the new guidance.

Familiarisation for Option 2

26. Only those “specified schemes” who levy flat fees would be expected to familiarise themselves with the regulations.

27. There would be one-off costs to all the ‘specified scheme’ trustees to familiarise themselves with the new guidance.

28. It is assumed that it would take all trustees of in-scope schemes approximately 3.5 hours to read and understand a 35-page guidance document. It is also assumed that it would take around 6 minutes to read each page, based on previous impact assessments.

29. It is estimated that schemes in scope of the proposed requirements will have approximately 6 trustees per scheme, based on engagement with industry, with an estimated average hourly cost (including overheads) of £100 per hour.

30. These total one-off costs to all schemes in scope are estimated to be £12,600.

Familiarisation with exact requirements

6 providers in scope x 3.5 hours spent familiarising x 6 trustees at provider x £100 trustee wage = £12,600

31. If “specified schemes” then decided based on the guidance to implement a policy to deal with the erosion of small pots by flat fees this would be an optional cost and is therefore not included here.

Policy objective

32. The policy objective is to limit the erosion of small pension pots by flat fee charges and prevent any members from being charged out entirely by flat fees. Although there needs to be a balance between protecting members, especially those with small pots, and maintaining the financial sustainability of schemes, it is important to maintain public confidence in automatic enrolment and workplace pension saving.

33. As evidenced by the PPI report into financial sustainability, the DC pensions market is still relatively immature and some providers are still in the process of repaying start up loans. These providers must balance delivering value for money for their members and their financial sustainability going forward.

[13] https://publications.parliament.uk/pa/bills/lbill/58-01/004/5801004-IA-Annex-E.pdf

Preferred Option (Option 1) – De minimis on flat fees

34. **The preferred option is the introduction of a level or de minimis where providers can no longer charge flat fees on the smallest pots**. This will apply to all members in the default fund of qualifying schemes used for workplace pensions and will be set at £100. Where a member's rights (i.e. the sum total of their pension pot or pots with a provider) is at £100 or below, then no flat fee could be charged to that member.

35. It is intended to introduce secondary legislation to amend the Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015. It is intended to implement this change from April 2022.

Monetised and non-monetised costs and benefits of each option

	Option 0: Do nothing	Option 1: £100 de minimis	Option 2: Guidance only
Familiarisation	Not applicable	£13,300	£12,600
System Updates	Not applicable	£1,650,000	Optional
Communications	Not applicable	£290,000	Optional
Foregone revenue (per year)	Not applicable	£6,330,000	Optional

Direct costs and benefits to business calculations

Costs to Pension Schemes in Scope

36. The proposed elements of costs are divided into:

- One-off familiarisation cost to the "specified schemes" to read and understand the regulations.
- One-off system changes and testing costs to enable "specified schemes" to update their systems to stop charges being applied to the affect pension pots.
- One-off communication and marketing costs to notify employers and members of the changes to charges resulting from the implementation of the de minimis. Additional costs to update scheme documentation and literature, member communications and portals, and websites to reflect the changes to charges resulting from the implementation of the de minimis.
- Ongoing loss of revenue by no longer charging flat fees to pots of £100 or less.

Year	2021/22	2022/2023 – 2030/2031
Appraisal period year	1	2-10
Event	Regulations laid (March 2022) De minimis comes into force	De minimis in place
Cost	Familiarisation with secondary legislation and guidance System updates Implementation Communication and marketing costs Initial loss of revenue	Ongoing loss of revenue on any future pots of £100 or less
Benefit	Members with pots of £100 or less do not incur flat fees	Members with pots of £100 or less do not incur flat fees

37. The analysis in this section is based on engagement with industry and with cost information shared from all the “specified schemes”. The cost information itself is commercially sensitive information which is not suitable for publication.

Familiarisation

38. Only those “specified schemes” directly affected by the de minimis will be expected to familiarise themselves with the regulations.

39. There would be one-off costs to all the ‘specified scheme’ trustees to familiarise themselves with the new regulations. A pension scheme in scope will experience this one-off cost in the first year only.

40. It is estimated that it would take all trustees of in-scope schemes approximately 3.7 hours to read and understand the regulations and guidance. It is assumed the regulations are 2 pages and the guidance is 35 pages. It is also assumed that it would take around 6 minutes to read each page, based on evidence used within previous impact assessments.

41. It is estimated that schemes in scope of the proposed requirements will have approximately 6 trustees per scheme, based on engagement with industry, with an estimated average hourly cost (including overheads) of £100 per hour.

42. These total one-off costs to all schemes in scope are estimated to be £13,300.

Familiarisation with exact requirements

6 providers in scope x 3.7 hours spent familiarising x 6 trustees at provider x £100 trustee wage = £13,300

System updates

43. Based on discussions with “specified schemes” it is expected there will be a one-off administrative cost to “specified schemes” of stopping pots of £100 or less being charged flat fees. This one off administrative cost will entail:

- Planning and development of system changes required to adhere to the de minimis;
- Testing any changes made to the system.

44. This cost will vary between different “specified schemes” depending on factors such as whether they already operate a de minimis or the complexity of the systems that need updating. From industry engagement, it is known that two affected schemes operate a de minimis and it is expected that their system updating costs would be minimal.

45. This cost will involve trustees, senior managers, IT and software resource. Systems will need to be updated to prevent pots of £100 or less being charged the flat fee. Any changes to these systems will require testing.

46. Providers can manage their schemes internally or via a third party. For a scheme with good data management and platforms, they may be able to identify these pots quickly and make the necessary changes without incurring excessive additional costs. However, schemes who use third-party platforms may have to pay to amend their contract or ask their contractor to take on additional work.

47. Based on engagement with industry, it is estimated that the aggregate costs to “specified schemes” is £1.65 million. Due to commercial confidentiality and the agreements with which these costs were shared by the “specified schemes”, it is not possible to publish any additional details on these costs.

System updating costs

Best estimate = £1,650,000

48. Some “specified schemes” also outlined there may be additional ongoing testing of the system in the future. However, this is optional and part of the running costs of pension administration regardless of the implementation of the de minimis. Therefore, it is has not been included within costs to business.

Communication and Marketing costs

49. It is estimated there will be a one-off communication cost to “specified schemes” to notify employers and/or members about the changes to charges resulting from the implementation of the de minimis. This cost will vary between different “specified schemes” depending on factors such as whether they already operate a de minimis or how they choose to notify members. For example, sending a letter to all members is likely to be more expensive than emailing. Some “specified schemes” outlined they may not be able to contact deferred members.

50. One ‘specified scheme’ outlined that they expect some increased member queries and engagement following the implementation of the de minimis although they are not able to quantify what these costs may be.

51. Some “specified schemes” outlined that notifying members of the de minimis coincided with other regular member communications and therefore the additional cost was negligible.

52. As well as communicating directly with employers and/or members, “specified schemes” will be required to update supporting materials. This may include, but is not limited to:

- Updating charges information on websites
- Updating member portals
- Updating scheme documentation and literature
- Updating benefit annexes and employer information.

53. This change may involve communication or marketing colleagues’ time to work out where changes are needed. Then new content must be created which will then be signed off by trustees. There is also additional time to update the communications once signed off. Engagement with industry said it was often hard to distinguish between the communication and marketing costs.

54. Based on engagement with industry, it is estimated that the aggregate costs to “specified schemes” is £290,000. Again, due to commercial confidentiality and the agreements with which these costs were shared by the “specified schemes”, it is not possible to publish any additional details on these costs.

Communication costs

Best estimate = £290,000

Foregone revenue in year 1

55. It is estimated that there will be ongoing loss of revenue to "specified schemes" going forward as they will no longer be able to levy flat fees on pots worth £100 or less.

56. To calculate loss of revenue it is necessary to know the number of pots worth £100 or less that are subject to flat fees and the flat fee that is levied. This is commercially sensitive information which is not suitable for publication. Where appropriate aggregate figures have been used to outline the number of pots affected the loss of revenue.

57. Once the regulations come into force, for providers charging a flat fee it may only be levied to the extent that it would not reduce the value of the member's rights to below £100. Therefore, providers will also lose revenue on some pots worth over £100 due to only being able to charge a partial flat fee to bring the pot size down to, but not below, the level of the de minimis. It is not possible to estimate the number of pots that this applies to nor the lost revenue from this due to lack of sufficiently granular data. The data that has been gathered from providers is based on aggregate figures of members for specific pot value bands.

58. However, not all of the pots worth £100 or less that were provided by the "specified schemes" will currently be subject to the flat fee. According to existing legislation, providers are only permitted to levy a flat fee on an individual once regardless of the number of pots they may hold with that provider. As there are a small number of large master trusts and they tend to have strong links with particular sections of the labour market it is likely that as individuals move jobs they will repeatedly be enrolled into pensions with the same providers. Research by the Pension Policy Institute[14] found that this could be in the region of 20% to 50% of deferred pots. This would therefore reduce the estimate of total forgone revenue by between 20 and 50%. From engagement with industry there may be operational reasons as to why members' pots cannot be matched and therefore some members may be charged flat fees on more than one pot under current legislation. However, there is no available evidence as to the extent of this. This would be expected to lower the 20-50% estimate.

59. Finally, any revenue loss could be partially or fully off-set by providers increasing flat fees for those above the de minimis or by increasing percentage charges applied to all members. Evidence from the Charges Survey 2020 suggests that on average, charges are low across the DC market, and that competition between providers is a significant factor in driving down average charges.

60. Based on the information provided by the six "specified schemes" the best estimate of the number of pots worth £100 or below that are subject to flat fees is 1.5 million. This was a point in time estimate of a dynamic population, therefore it is expected that this estimate would have changed since the data request. It is not possible to quantify this uncertainty, but it is explored further in the next section as it becomes more meaningful over time.

61. From the information provided throughout this section, the best estimate of the loss of revenue on these pots is therefore £6.33 million.

Foregone revenue

Best estimate = £6,330,000

Loss of revenue (going forward)

62. As noted above, this is a dynamic population, so the estimate of the number of pots impacted by the policy change is not expected to remain at 1.5m over time.

[14] https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf

63. There are two main ways in which this number of pots could increase:

a) from new pots of £100 or less being created by new members of pension schemes who charge flat fees;

b) from pots of over £100 with providers who charge flat fees falling to £100 or less; and

c) becoming subject to the de minimis.

64. Similarly, there are three main ways in which the number of pots subject to the de minimis could fall over time:

a) from pots growing to above £100 through contributions from the employee and employer and/or investment growth;

b) from pots being moved to a provider who does not charge a flat fee; and

c) from deferred pots of £100 or less being charged out to zero and no longer attracting a flat fee.

65. Further data and evidence on each of these is laid out below to inform consideration whether the overall stock of pots of £100 or less would be expected to increase or decrease over time.

66. Firstly, analysis of HMRC RTI data shows that the average monthly number of eligible employees starting to save into a workplace pension each month was around 375,000 in 2021. As shown in Table 2 this was a slight increase from the average in 2020, but a slight decrease from 2018 and 2019. Due to the staged approach in which Automatic Enrolment was introduced some (mainly micro) employers reached their staging date in 2018, meaning slightly higher numbers would be expected that year. Due to the impacts on the labour market of the SARS-CoV-2 pandemic the number of employees starting new jobs and saving into a pension each month is expected to be lower on average in 2020 and 2021.

Table 2: Average number of eligible employees starting saving into a workplace pension each month

	2018	2019	2020	2021
Average monthly inflow	415,000	410,000	340,000	375,000

Source: DWP estimate derived from HMRC Real Time Information (RTI) data

67. Data from TPR[15] shows that in 2020/21 memberships of non-hybrid DC master trusts was 18.6 million, up from 16.3 million in 2019/20, an increase of about 2.3 million memberships[16]. Not all new memberships will be in the Master Trusts who charge flat fees, and this data does not provide information on the size of pension pots for these new memberships.

68. In order to estimate how many new pots created each month would be of £100 or less analysis was carried out on ASHE data on the amount of employer and employee contributions to DC pensions. It is not possible to do this for just new DC pension pots and so the numbers include contributions to existing pots as well. This analysis showed that of all people saving into a DC pension pot in 2020 91% had monthly employer and employee

[15] https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2020-2021#56a3fa2c08c44eaab6b7367f5f49b39e

[16] The number of memberships does not equate to the number of individuals, as one individual can have multiple memberships.

contributions of over £100, meaning the pot would not have been subject to the de minimis at all. Of the remaining 9% of people, around 5% would have contributions that reached above £100 in two months, 2% would have reached over £100 in three months and the remaining 3% would have reached it in four or more months. Assuming this level of contributions is reflected in those starting saving into a workplace pension this would suggest that only a minority of new pots would be subject to the de minimis each month.

69. Secondly, pots that are worth over £100 are at risk of erosion over the appraisal period and may become subject to the de minimis, especially if investment performance was particularly poor. However, the likelihood of negative returns is relatively low. The Barclays Equity Gilt Study 2020[17] looked at the distributions of investment returns over the last 120 years and the largest single year fall in that period was 50%. Therefore, in the worst case scenario, pots between £100 and £200 could be at risk. This risk is likely to be higher on deferred pots who are solely reliant on investment performance for growth. However, the same study showed that over the sample period, the worst average annualised 10-year return for equities was around -5%, while the best was over +15%.

70. Moreover, Pensions Policy Institute[18] modelling has assumed investment returns are around 5.3%, in line with the Office for Budget Responsibility's (OBR) forecast of asset yields from the Economic and Fiscal Outlook (EFO). Similarly, Corporate Advisor[19] analysis shows that for Master Trusts there was an average annualised 5-year return of over 6% in the most recent data.

71. In terms of how many pots of £100 or less and so subject to the de minimis are likely to grow to over £100 and move beyond the scope of the de minimis, the above analysis has shown that for the vast majority of active pots this is likely to happen within a couple of months. For deferred pots due to the lack of contributions any growth will only be due to investment performance, which wouldn't be expected to be above the flat fee charge.

72. There is no reliable estimate of the number of pots that are subject to the de minimis that might be moved to a provider who does not charge a flat fee. The Small pots working group report[20] looked at member-led solutions to the issue of small pension pots and concluded that due to low member engagement with their pensions they were unlikely to engage in the consolidation process and move their pension pot to another provider.

73. Finally, in terms of how many deferred pots might be eroded to zero and therefore stop being chargeable, again, granular data is not available to estimate this. On average, it is expected flat fees net investment growth to be around £10-£15 per annum for pots between £0 - £100. If pots below £100 were evenly distributed, it might therefore be expected that up to 15% of deferred pots would be charged out to zero per annum.

74. Due to the lack of evidence on the overall balance of these dynamics to inform how many pots are expected to be subject to the de minimis in future years, the best assumption is that the current figure of 1.5 million pots stays roughly stable over the ten-year appraisal period. Therefore, the loss of revenue from no longer being able to charge a flat fee on these pots will also be the same for each year.

[17] https://home.barclays/news/2021/05/The-economics-of-the-new-normal/
[18] https://www.pensionspolicyinstitute.org.uk/media/3828/20210609-ppi-adequate-retirement-incomereport.pdf?utm_medium=email&utm_campaign=PUBLISHED%20TODAY%20What%20is%20an%20adequate%20retirement%20income&utm_content=PUBLISHED%20TODAY%20What%20is%20an%20adequate%20retirement%20income+CID_ec2261e8506649931e3d48aa1d57cfbd&utm_source=Email%20marketing%20software&utm_term=To%20download%20the%20report%20plese%20click%20here
[19] https://corporate-adviser.com/master-trust-gpp-report-46pc-difference-in-5-year-returns-schemes-defy-pandemic/
[20] https://www.gov.uk/government/publications/small-pension-pots-working-group/small-pots-working-group-report#chapter-3--member-ledsolutions--analysis-and-recommendations

Sensitivity Analysis

75. For familiarisation, assuming a 50% decrease or increase in the hours a trustee takes to familiarise themselves with the regulation and guidance, the estimates are:

Familiarisation with exact requirements (Best estimate)

6 providers in scope x 3.7 hours spent familiarising x 6 trustees at provider x £100 trustee wage = £13,300

Familiarisation with exact requirements (Low estimate)

6 providers in scope x 1.58 hours spent familiarising x 6 trustees at provider x £100 trustee wage = £6,700

Familiarisation with exact requirements (High estimate)

6 providers in scope x 7.5 hours spent familiarising x 6 trustees at provider x £100 trustee wage = £20,000

76. For the high estimate it could be estimated that all pension schemes regardless of whether they levy flat fees may need to familiarise themselves with the regulations. However this is likely not meaningful as it is expected that Trustees will know what a flat fee is and judge quickly whether they are impacted or not. Flat fees are already a part of the permitted charging structures that Trustees have to operate within. However, for illustrative purposes, using TPR's[21] data of the number of DC schemes, the best estimate for this scenario is:

Familiarisation with exact requirements (High estimate – all schemes)

28,360 schemes x 3.7 hours spent familiarising x 6 trustees at provider x £100 trustee wage = £62,960,000

77. For systems changes and testing costs, assuming a 50% decrease or increase in the cost of updating any systems the estimates are:

System updating costs

Best estimate = £1,650,000
Low estimate = £825,000
High estimate = £2,475,000

78. Moreover, the estimates of system changes and testing costs ranged significantly between providers with some requiring more or less extensive work to be undertaken than others. Some providers suggested these costs were within their existing contracts so did not incur a significant additional cost. It was also raised that because the de minimis is a statutory change they did not see this as an additional cost but as a necessity to running the pension scheme legally. Estimates have been included which incorporate accounting for potential optimism bias using the standard Green Book optimism bias[22] recommended adjustment ranges for equipment or development projects. However, given that providers thought the majority of costs were mainly covered by existing contracts and work plans it's likely the risk of optimism bias is low.

System updating costs (optimism bias)

Upper estimate = £1,650,000 + (200% x £1,650,000) = £4,950,000
Lower estimate = £1,650,000 + (10% x £1,650,000) = £1,815,000

[21] https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2020-2021
[22] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/191507/Optimism_bias.pdf

79. For communication and marketing costs, assuming a 50% decrease or increase in the cost of updating any systems, the estimates are:

Communication costs

Best estimate = £290,000
Low estimate = £145,000
High estimate = £435,000

80. Similarly to the system updating costs, providers estimated a range of costs. Some providers suggested the costs of updating marketing and communication were difficult to estimate as they were part of the day-to-day running costs and therefore didn't incur large additional costs. However, most were able to provide us with an aggregate figure of cost. Estimates accounting for potential optimism bias have been included using the standard Green Book optimism bias recommended adjustment ranges for equipment or development projects. Given most providers felt these costs fell within the day-to-day running of the scheme, the risk of optimism bias is low.

Communication costs (optimism bias)

Upper estimate = £290,000 + (200% x £290,000) = £870,000
Lower estimate = £290,000 + (10% x £290,000) = £319,000

81. For future forgone revenue costs, assuming a 50% decrease or increase in the future foregone revenue:

Future foregone revenue costs

Best estimate = £6,330,000
Low estimate = £3,170,000
High estimate = £14,610,000

Non-monetised costs

Cross-subsidy

82. The Pensions Policy Institute in a report on pension charging structures and beyond[23] defined cross-subsidies as a member paying more in charges than the costs incurred on their behalf, while at the same time a different member pays less in charges than the costs they incur.

83. Cross-subsidies exist within all charging structures but are more common in single percentage charging structures. Using a flat fee can help reduce some of the cross-subsidy between larger and smaller pots.

84. In the same report the Pensions Policy Institute found that in a Master Trust that uses a proportion of fund charge, smaller pots are subsidised by larger pots. Inactive pots tend to be smaller than active pots. The increase in the ratio of inactive pots to active pots increases the extent to which active pots may need to support the inactive pots. This type of cross-subsidy could increase if schemes can no longer charge flat fees on pots of £100 or less. This could be viewed as unfair to members who are continually saving into their pension pots having their contributions used to preserve the pots of others.

85. It could be viewed that charges on small pots are predominantly to cover the cost of administering them; and that with the introduction of the de minimis this cost will need to be

[23] https://www.pensionspolicyinstitute.org.uk/media/3263/20190911-pension-charging-structures-and-beyond.pdf

absorbed or redistributed across other pots if the provider does not or cannot absorb the revenue loss. This could be through increasing the flat charge above the level of the de minimis resulting in other members cross-subsidising smaller pot members.

86. There cannot be certainty on how the added costs or loss in revenue to some providers may be passed onto members. Given that all members of qualifying schemes are below the cap and the average charge is fairly low, it could result in charges for members with pots larger than £100 increasing to subsidise the de minimis or the percentage charge rising for all members. Trustees have a fiduciary duty to act in the best interests of all their members and such changes would be made in the light of that overall duty. Without any concrete evidence it is not possible to calculate this potential impact.

87. According to a Pensions Policy Institute[24] report on Master Trust financial sustainability their annual expenditure has been growing year on year, with cumulative expenditure around £1 billion by 2019 and costs expected to continue to grow. The report also found the Master Trust industry is unlikely to achieve breakeven on costs until around 2025 and the potential loss in revenue may push this back further for the affected Master Trusts unless they increase their charges. Financial sustainability is a challenge for automatic enrolment providers and delaying paying back their loans may affect Master Trust ability to scale their assets, pursue innovation and prepare for future challenges and regulation.

88. However, as noted in the report Master Trusts are growing and the industry is nearing the point of breakeven. The majority of Master Trusts do not charge flat fees and so will not be impacted by this measure. The Pension Charges Survey 2020 also found that pension providers felt under pressure to maintain low charges due to competitive pressure. This suggests that pension schemes may not necessarily raise charges on other members in order to pass on the costs of no longer being able to charge flat fees for pension pots of £100 or less.

Consolidation

89. The introduction of a de minimis may disincentive members from consolidating their smaller pots as they are at less of a risk of pot erosion.

90. A greater number of small pots due to reduced consolidation could mean more cross-subsidisation of pots and more or less revenue for providers.

Opportunity Cost

91. Engagement with industry has highlighted that in order to implement the de minimis other work may have to be put on hold or postponed. Implementation requires the time of trustees, marketing and IT support at a minimum. Therefore, there may be other projects or innovation which are not pursued in order to meet the regulatory requirements of the de minimis. Some of these may have been beneficial to both the provider and members.

Benefits to Pension Schemes

Reputation

92. It is damaging to the success and reputation of auto enrolment and the workplace pension industry if members have their pots eroded significantly by charges. By ensuring members' pensions are protected from excessive charges it should help limit pot erosion and maintain the reputation of the DC pension industry.

[24] https://www.pensionspolicyinstitute.org.uk/media/3590/20200827-ppi-financial-sustainability-of-master-trust-schemes-final.pdf

93. Whilst benefit cannot be quantified, it is generally accepted that saving into a workplace pension is a beneficial choice for the majority of the working-age population. If the reputation of automatic enrolment was damaged by charging out it would undermine the key purpose of workplace pensions: to get people saving for retirement.

Benefits to Members

Savings to affected members

94. It is estimated that there will be ongoing benefit to members with pots £100 or less who will no longer be charged flat fees. The best estimate of the number of pots £100 or less that are subject to flat fees is 1.5 million. Reference is made to pots rather than the number of people because it is possible for someone to own more than one pot and therefore benefit from the saving more than once.

95. The best estimate of the savings to members is £6.33 million each year.

Risks and assumptions

Assumptions for flat fees

96. The Pension Charges Survey 2020 found four out of the 20 providers interviewed levied a flat fee, of which three were trust-based schemes so within the scope of these regulations. However, some providers have adopted a flat fee since the survey was conducted.

97. Therefore, it is assumed based on the Pension Charges Survey 2020, that there are at least six providers who may be impacted, although some of these providers do not levy flat fees on all members.

98. It is assumed that the introduction of a de minimis would have a limited impact on the biggest providers, as the flat fee charging structures is still in the minority across DC large providers. However, it is worth highlighting some of the "specified schemes" are newer Master Trusts associated with the "heavy-lifting" of automatic enrolment (meaning those Master Trusts who have taken on administering pension schemes for a higher proportion of lower earners automatically enrolled into pension saving for the first time). These schemes are newer and paying back set up loans whilst building their assets. These schemes are more likely to have taken on smaller pots and service a large proportion of the automatic enrolment market.

99. The Pension Charges Survey 2020 found the average flat fee ranged from £13 to £20, with the highest fee found at £36. Flat fees charged by affected providers range from between £2.50 per annum to £24 per annum.

100. Costs are likely to vary between providers. For example, two providers have already adopted a de minimis and therefore costs for these providers are likely to be lower.

Assumptions for familiarisation

101. It is assumed only "specified schemes" within the scope of the regulations will need to familiarise themselves regardless of whether the de minimis will directly affect their charging structure. It is estimated there are 6 providers who will be affected.

102. It is assumed that the average cost of an hour of time for a Trustee is £100 per hour, this is based on engagement with the industry and previous pensions impact assessments.

103. It is also assumed that there are approximately 6 trustees per scheme, based on engagement with the industry.

104. For familiarisation costs a reading time of 6 minutes per page for Trustees has been assumed.

105. It is assumed the regulations will be 2 pages and accompanying guidance will be 35 pages.

Assumptions for system updates

106. It is assumed that only "specified schemes" within the scope of the regulations will need to update and test their systems and infrastructure.

107. It is assumed that two providers will have lower system update costs as they have already adopted a de minimis. For the other four providers it is expected that their costs would be higher.

Assumptions for communication costs

108. It is assumed that only "specified schemes" within the scope of the regulations will need to communicate these changes. It is at the discretion of the provider how they decide to communicate these changes.

109. This evidence was gathered via engagement with industry. It is assumed providers will only need to directly notify employers and members once.

Assumptions for foregone revenue / member savings

110. Due to commercial sensitivity and availability of data, aggregate figures have been used to outline the number of pots affected and the loss of revenue.

111. To calculate loss of revenue it is necessary to know the number of pots worth £100 or less which are subject to flat fees and the flat fee that is levied. This is commercially sensitive information which cannot be published. Where appropriate aggregate figures have been used to outline how the number of pots affected revenue.

112. The best estimate of the number of pots worth £100 or less that are subject to flat fees is 1.5 million. Using the mid-point of the Pension Policy Institute's estimate[25] that between 20% and 50% of pots may belong to the same member, has resulted in discounting the best estimate of the loss of revenue by 35%. Therefore the best estimate, based on the information provided, of the loss of revenue on these pots is £6.33 million.

Assumptions for future foregone revenue

113. The best estimate of the number of pots worth £100 or less over the next 10 years assumes the current level remains stable. Another option would have been to use the Pensions Simulation model, however there are a number of caveats about using this model:

[25] https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf

- The model is not designed to model rapid job churn and turnover and it is expected that these types of individuals would be responsible for the making of small pots in the future.
- The model looks at individuals rather than providers, therefore it is not known what pension provider the pot is and what kind of charge they would be subject too. It is therefore assumed that 1 in 4 will be subject to flat fees and the flat fee is around £15, based on what is known about current coverage.
- The model does not account for any changes to national insurance or pension contributions so there may be circumstances where individuals may contribute more or less to their pension.
- These estimates do not account for any future small pots solution.
- The number of pots worth £100 or less modelled for the current year (for the industry as a whole) is a lot lower than the figures provided by just the six "specified schemes" who were requested to supply data, suggesting there is a clear undercount of the very smallest pots.

114. Due to these and the lack of better estimates on how many pots subject to the de minimis there might be in the future, the best assumption is that the current figure of 1.5 million pots stays stable over the ten-year appraisal period. Therefore it is estimated that the loss of revenue going forward is £6.33 million.

Impact on small and micro businesses

115. The proposed regulations will impact any provider who operates a qualifying scheme used for workplace pensions and who levy a flat fee. This may include small and micro pension businesses although most small businesses do not administer their own pension schemes, but instead use an external provider to meet their duties.

116. TPR[26] found of the 28,360 schemes in the DC landscape, 22,350 (79%) have identified themselves as relevant small scheme or an executive pension plan with 12 member or less.

117. It is acknowledged that pension scheme members have little or no choice over the scheme they are in, and by including small and micro businesses ensures all members have a degree of protection for their pension savings.

118. Of the 6 schemes identified none are small or micro businesses. As reported in the Pension Charges Survey 2020 flat fees have become more common in recent years and particularly for larger Master Trusts, therefore it is unlikely that they are used by small or micro businesses.

Wider impacts

Market competition

119. Financial sustainability is a challenge for automatic enrolment providers and delaying paying back their loans may affect Master Trust ability to scale their assets, pursue innovation and prepare for future challenges and regulation.

120. There is no available evidence on the finances of those who levy a flat fee, but they may seek to:

[26] https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2020-2021

- Re-finance
- Exit the market
- Increase charges on other groups
- Pause other ongoing projects or innovation

In order to cover the loss of revenue from pots of £100 or less. This may put them at a financial disadvantage against providers who do not levy a flat fee and therefore have no financial implications from the de minimis.

Affected member characteristics

121. There is no available data on the characteristics of those with pots of £100 or less who pay flat fees. The Wealth and Assets Survey has been used as a proxy for the types of people who have smaller pension pots. The Wealth and Assets Survey is self-reported; therefore, it relies on accurate reporting of respondents which is not always the case. Some of the data cannot be directly compared with other sources.

122. Analysis of the Wealth and Assets Survey found small retained pots (also known as deferred pots) are found in the highest numbers amongst:

    - Women
    - Lower earners
    - Younger individuals

    There are caveats to this analysis but it can be estimated that these groups may benefit the most from the introduction of the de minimis.

123. For example, 85% of retained DC pots which belong to those aged 16-24 are worth less than £2500, compared to 26% of retained DC pots belonging to those aged 45-54 and 22% of retained DC pots belonging to those aged 55-64.

124. Moreover, 43% of retained DC pots which belong to individuals with income between £10,000-£19,999.99, are worth less than £2,500. The corresponding figure is 34% of retained DC pots for income group £40,000-£49,999.99.

Member engagement

125. Many members do not make active choices about their workplace pensions. According to TPR[27], around 95% of memberships in DC schemes are invested in the scheme's default strategy. The Pension Policy Institute[28] found this was even higher for members in Master Trust scheme with an estimated 99% in the default strategy.

126. This evidence suggests the majority of members in DC schemes do not make active choices about how their pensions are managed. Therefore, the introduction of a de minimis is not expected to significantly impact members' decision to consolidate their pots or member engagement.

Monitoring and Evaluation

[27] https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2019-2020
[28] https://www.pensionspolicyinstitute.org.uk/media/3590/20200827-ppi-financial-sustainability-of-master-trust-schemes-final.pdf

127. There is no plan, at this stage, to undertake a specific future formal statutory review of the de minimis measure. In view of the interaction of this policy with potential solutions to tackle the proliferation of small pots, and potential future reform of the permitted charging structures, future policy on the de minimis will be considered in conjunction with detailed proposals on these wider policy areas.

Other Impacts

Equality

128. In accordance with its duty under section 75 of the Northern Ireland Act 1998, the Department has conducted a screening exercise on these legislative proposals and has concluded that they would not have significant implications for equality of opportunity and considers that an Equality Impact Assessment is not necessary.

Environmental

129. There are no implications.

Rural proofing

130. There are no implications.

Health

131. There are no implications.

Human rights

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

Competition

133. There are no implications.

Approved by:	Anne McCleary Director of Social Security Policy, Legislation and Decision Making Services	**Date:**	7 March 2022

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