Charge cap review commences

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The Department of Work and Pensions (DWP) has issued a Call for Evidence seeking views on the effectiveness of costs, charges and transparency measures in protecting pension member outcomes. In particular, the DWP wants input on the 'level and scope' of the charge cap that applies to Defined Contribution (DC) default arrangements used for auto-enrolment. This could mean a squeeze on providers to bring charges down – although this doesn't automatically guarantee better value...

The results of this Call for Evidence will, in conjunction with a Pension Charges Survey, inform the Government's review of the default fund charge cap.

History of the cap

The charge cap was initially introduced in 2015, with the aim of protecting automatically enrolled members from 'excessive and unfair' charges, and is currently set at 0.75%. In 2017, the Government carried out a review of the measures and, while it chose not to make changes to its operation at that time, it committed to reviewing the cap again in 2020.

Level of cap

The upcoming Charges Survey will seek evidence from providers on costs, and their underlying drivers, in order to inform the future level of the cap. There are, of course, arguments to be made on both sides here, with low cost not always equating to better value. For example, while a decrease in charges might be welcome, it could also limit schemes' abilities to maintain diversified portfolios, and may stifle innovation.

Scope of cap

Amongst other things, the Call for Evidence seeks views on whether transaction costs should be brought within the scope of the cap. This was considered in 2015, but they were ultimately excluded owing to transparency concerns, as well as fears that including such charges could restrict the ability of asset managers to trade. In 2017, the Government decided again to delay bringing transaction costs within scope, to allow time for the Financial Conduct Authority's (FCA) then new transparency rules to bed in.

While some challenges remain, steps have been taken since 2017 to improve issues around cost calculation and disclosure. As a result, the Government is asking again whether transaction costs should be brought within the cap's scope. As an alternative, it notes the possibility of a separate cap for transaction costs.

Cost disclosure

Following studies, including by the FCA, concluding that institutional investors find it difficult to obtain the necessary information to accurately compare costs, the Government also asks how best to achieve full take-up of the Cost Transparency Initiative (CTI) disclosure templates (requiring standardised cost and charges information from asset managers).

While early indicators of voluntary use have been positive, industry-wide adoption is not expected for some time. Compulsion remains under consideration by the DWP, although it notes that this would not be its preference.

Implications for schemes

Guy Opperman has called the review "an important step towards ensuring charging structures are fair, transparent and effective for the long term, delivering value for money". Any changes will have implications for schemes in terms of administration, investment decisions and funding strategies. However, whether 'value' for members will be measurably impacted remains to be seen.

What next?

The Call for Evidence ran until 20 August, with the DWP aiming to publish its eventual proposals later this year.