EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL AND PERSONAL PENSION SCHEMES (AUTOMATIC ENROLMENT) (AMENDMENT) REGULATIONS 2013

2013 No.

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

This instrument amends regulations setting out the conditions for automatic enrolment pension schemes. It adds a condition in relation to any part of an occupational pension scheme that provides money purchase benefits or any part of a personal pension scheme that provides money purchase benefits. The scheme must not include a provision which allows for any amount to be deducted from contributions or investment returns, or for the value of a jobholder's rights to be reduced by any amount, where the amount is to be paid to a third party under an agreement between the employer and the third party. If it does, the scheme will not be an automatic enrolment scheme.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None.

4. Legislative Context

4.1 The Government introduced automatic enrolment into workplace pensions from October 2012, starting with the largest businesses first. The legislation on workplace pensions imposes a duty on employers to automatically enrol workers who meet age and earnings criteria into a workplace pension scheme which meets minimum requirements.

4.2 From January 2013, the Financial Service Authority's Retail Distribution Review (RDR) banned pension providers from paying commission to advisers for recommending their products.

4.3 The RDR introduced a new concept of consultancy charging. Where an employer is not prepared to pay a fee to an adviser, but wants to use an adviser in connection with providing a workplace personal pension, they are able to agree a consultancy charge with the adviser. Consultancy charges enable employers to pass on the costs of advice to the individual members who join the pension scheme.

4.4 Over the next five years as automatic enrolment rolls out, up to 11 million people will be automatically enrolled into a workplace pension scheme. It is important that people are enrolled into schemes which offer both transparent and value for money charges.

4.5 In April 2013, the Work and Pensions Select Committee report "Improving governance and best practice in workplace pensions" (http://www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/inquiries/parliament-2010/governance-and-best-practice-in-workplace-pensions/) recommended that the Government ban the use of member-borne consultancy charging in auto-enrolment qualifying schemes without delay.

4.6 On 10 May 2013, in a written statement (http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm130510/wmstext/130510m0001.htm#13051033000008), the Minister of State announced his intention to legislate to ban consultancy charges in automatic enrolment schemes.

5. Territorial Extent and Application

This instrument applies to Great Britain. The Department for Social Development in Northern Ireland will be producing its own legislation replicating these regulations for Northern Ireland

6. European Convention on Human Rights

The Minister of State, Steve Webb MP, has made the following statement regarding Human Rights – 'in my view the provisions of the Occupational and Personal Pension Schemes (Automatic Enrolment) (Amendment) Regulations 2013 are compatible with the Convention rights.'

7. Policy background

What is being done and why

7.1 Concerns were raised that consultancy charges posed a risk to individual members. In November 2012, the Minister of State initiated a six month review of the interaction between automatic enrolment and consultancy charging.

7.2 The key findings of the review were that: a) the structure of consultancy charging was flawed in an automatic enrolment context; b) it had an unfair impact on some individuals, and c) it would be difficult to cap or effectively restrict it.

7.3 The Minister of State concluded that the consultancy charging mechanism was inappropriate in automatic enrolment schemes and should be banned. Consultancy charging is a Financial Conduct Authority (FCA) construction and, therefore, only exists as such in personal pensions. However, a similar mechanism could exist in occupational pension schemes and the decision, therefore, also extends to occupational pension schemes in relation to any money purchase benefits provided under such schemes.

Flawed structure

7.4 The fundamental concern with the structure of consultancy charging is that it creates a misalignment between the interests of the primary consumer (the employer) and the end customer (the member).

7.5 The party that chooses the service is the employer; the price is agreed between the employer and the adviser; but the fee is paid by the individual member. There is no incentive in the market to drive down costs and to ensure value for money. The member's only choice is to accept that they have to pay the consultancy charge to the adviser out of their pension pot or to opt out of the pension scheme and forgo the employer contribution.

Unfair impact

7.6 The review found that the impact of consultancy charging could be greater on more vulnerable individuals. Flat per-member fees have a disproportionate impact on low earners and transient workers are at greater risk of repeatedly having to pay 'initial' higher consultancy charges for the first year(s) in each employer's scheme.

Unsuitability of other solutions

7.7 During the review, a range of alternative solutions were discussed with pension providers and advisers to mitigate the risk posed by consultancy charges. This included looking at existing requirements from the FCA relating to transparency, the possibility of providing guidance and/or decency limits, and providing for a statutory cap.

7.8 These were rejected either because they did not adequately protect individuals or added complex monitoring requirements which would create an onerous compliance and enforcement burden.

Consolidation

There are no immediate plans to consolidate the Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 (S.I. 2010/772). However, the Department for Work and Pensions publishes the "Blue Volumes" which are online and can be accessed for free by members of the public. The Blue Volumes contain the legislation for which the Department is responsible. The legislation is presented in a consolidated form and is updated regularly. The weblink is: http://www.dwp.gov.uk/publications/specialist-guides/law-volumes/the-law-relating-to-social-security/

8. Consultation outcome

The Department for Work and Pensions carried out a through review of consultancy charging between November 2012 and April 2013. The pensions and advice industries were extensively consulted as part of this to establish how the market for consultancy charges was developing. The review concluded that current measures to prevent advisers from deducting high consultancy charges from members' pension pots are inadequate.

9. Guidance

The Pensions Regulator (TPR) is responsible for the delivery of communications, education and guidance to employers, intermediaries and the industry to support the compliance regime. They will provide guidance to employers and their intermediaries on how to comply with the law.

10. Impact

An impact assessment has not been produced for this instrument as it has no direct impact on businesses, the public sector or civil society organisations.

11. Regulating small business

The legislation applies to small business in the same way as it does to larger business.

12. Monitoring & review

The effects of this change will be monitored through the DWP Pensions Landscape and Charging survey and TPR's 6 monthly tracker survey of intermediaries to understand any changes in behaviour over the coming months.

13. Contact

David Reid at the Department for Work and Pensions Tel: 020 7449 7258 or email: david.reid3@dwp.gsi.gov.uk can answer any queries regarding the instrument.