Why charges matter

David Brown talks through The People's Pension's changes to its charging structure

The industry has come a long way since the days of the very highest of charges before the stakeholder pension charge cap was set at 1.5 per cent for the first 10 years and 1 per cent for the remainder of the life of the policy.

Since then, charges have continued to fall. Partly as the result of political pressure, in the form of the auto-enrolment charge cap, and partly as the result of the entry of master trusts into the market, pooling the fixed costs of pension scheme provision over a much larger group of members. This gave rise to a workplace pensions market during the staging of auto-enrolment that was much more competitive and much cheaper. We launched The People's Pension in this environment with a 0.5 per cent Annual Management Charge (AMC), well below the 0.75 per cent charge cap.

The People's Pension recently changed its charging structure to respond to a market that has changed further and to reflect the gains we have made as a larger and more mature scheme. The revised charge structure features an annual £2.50 cash charge, a management charge of 0.5 per annum and a rebate on some of the management charge. This is a development that we are very proud of as we think it delivers a competitive and fair charging structure.

The hard part in setting workplace pension charges is that costs, complexity and fairness trade off against each other. We have redesigned our charge structure to strike what we think is the right balance between these three things for our membership.

Percentage charges may result in low charge rates but high charges for members with larger pots and very low charges for members with very small pots that do not cover the cost, or even the regulatory fees, of providing a pension pot.

In an environment where there are millions of small, deferred pension pots, common as a result of auto-enrolment, schemes may rely on a smaller number of members with larger funds to cross-subsidise the costs of managing the smaller pots. This is not a sustainable situation for a well-run scheme and this issue was a factor in the introduction of our annual £2.50 cash charge that works to reduce cross-subsidy. We are working with the DWP and others in the industry to bring forward a solution to the underlying small pots problem.

As touched upon earlier, we also, effectively, cut our annual management charge by means of a rebate that works to give members cashback on their pension savings, the more they save with us. As a member's savings hit key milestones – £3,000, £10,000, £25,000 and £50,000, we apply a monthly rebate and automatically add money back into their pension savings. The level of rebate increases at each stage, reducing the impact the charge has on their savings, and in so doing, leaving more money invested for their future.

For someone with £15,000 in their account, over the course of a typical year, £17 will be added to their pot, with this increasing the more they save for their retirement. This kind of sum might not sound much to start with but compound the rebates across the accumulation years and they could add a significant amount to an individual's retirement savings – more than £14,000 for an average earner[1].

Nothing stands still and further change is inevitable. We expect the workplace pensions market to become even more competitive with significant consolidation of both providers and pots. We expect the latter to be driven both by dashboards and, increasingly by government encouraging industry to automatically consolidate small dormant pots. This will create a tougher operating environment for providers but we expect the emergence of providers with even greater scale leading to lower charges for members.

We are not there yet but we have come a long way in the past 20 years. We hope that the next 20 see as much progress.

Written by B&CE, provider of The People's Pension, chief strategy and innovation officer, David Brown

In association with the people's pension

[1]. Assuming a member aged 35 with a starting fund of £15,000, a salary of £30,000 per year, paying 8 per cent gross contributions, based on qualifying earnings for the 20/21 financial year, investment returns of 5 per cent per annum, inflation of 2.5 cent per annum, and a retirement age of 68, this could add up to an extra £14,566.

Discover how The People's Pension new charging structure works at www.thepeoplespension.co.uk/clear-pension-charges. Or email us on rrm@thepeoplespension.co.uk