Report on Pension Charges in Ireland 2012

Pensions Council 15th April 2015

Terms of Reference/Scope

- Fact finding report to establish whether charges are:
  (a) reasonable and
  (b) Transparent
- Costs arising during the pension cycle
- Focus on standard pension savings options
- Focus of the research was on the impact of the scheme member/policy holder.

Survey Categories and Pension Type

Group Pension Arrangements	Individual Pension Arrangements
Defined Benefit Schemes	Retirement Annuity Contracts (Personal Pension Plans)
Defined Contribution Insured Schemes	Executive (One Man) Pension Plans
Defined Contribution Non Insured Schemes	Personal Retirement Savings Accounts
Public Sector AVC schemes	Buy Out Bonds

Types of Charges – Disclosed/Explicit

- Annual Management Charge
- Contribution charges
- Allocation Rates
- Bid/Offer Spread
- Policy Fee
- Commission (initial, renewal, fund based, volume based)
- Exit fee

Some or all of these apply to schemes/policies Charges frequently “bundled”

Types of Charges - Non- disclosed /Implicit

- Implicit costs relate to the operation of the investment fund and can be summarised as:
  - **Operational Costs** (such as custodian fees, trustee fees, audit fees etc.);
  - **Trading Costs** (typically brokerage commissions payable when an asset of the fund is bought or sold);
  - **Stamp Duty** and other taxes (taxes related to share dealing in certain jurisdictions).

Reduction in Yield (RIY)

•Selected as being the most appropriate indicator to facilitate a wider understanding of pension charges.

•The RIY value gives a single percentage figure to express the impact of all charges (disclosed and non-disclosed) on the member/individual policy holder's fund over a period of time.

•It sets out the reduction in the yield (or return) that would otherwise have been provided if the policy carried no charges at all.

•although RIY calculations provide a good basis for comparison between products, they will vary depending upon the assumptions used.

Assumptions

- RIY calculated on the basis of:
- Occupational pensions
  – 35 years of age saving €500 per month for 30 years receiving a return of 5% p.a.
- Individual pensions
  – 35 years of age saving €250 pre month for 30 years – also transfers €25,000

Calculated duration to maturity, also looked at 2 and 10 years

Approach to Research

- Questionnaires sent to
  - Trustees of DC and DB pension schemes
  - Providers
  - Intermediaries/Advisors
  - Investment Managers

- Pilot survey
- Compare and validate responses
- Fund types

Research Response

The response to the survey questionnaires was as follows:

•Trustees:	340 out of 1015
•Intermediaries:	37 out of 60
•Life Companies:	12 out of 14
•Investment Managers:	8 out of 9

Data issues:

- Low trustee response despite efforts
- Intermediary response: replied in broad ranges, difficult to analyse
- Lack of individual policy holder information

	Min/Max RIY Range disclosed charges	Impact on projected Fund Values based on Average RIY	
		Disclosed	All charges
DCNI	0.09% – 0.97% (Maturity)	5.0% - 9.6%	8.4% - 12.7%
DCI	0.25% – 1.71% Maturity	8.6% - 14.4%	11.9%- 17.4%
	0.26% – 1.83% (2yr)	14.9% - 25.1%	17.9% - 28.1%
	0.26% – 1.68% (10yr)	11.8% - 19.8%	14.8% - 22.8%
Individual Pension Arrange-ments	0.89% – 3.08% (Maturity)	19% - 28%	21%- 31%
	1.07% – 3.64% (2yr)	38% - 49%	41% - 52%
BOBs	0.53% – 2.62%	19.5% - 26.2%	24% - 30%
PS AVCs	0.72% – 2.2%	22%	25%

0.0% 0.5% 1.0% 1.5% 2.0% 2.5% 3.0% 3.5% 4.0%

Research Observations

- Variability of Charges
- Economies of Scale
- Prevalence of Legacy Charges
- Prevalence of Commission
- Costs not met by scheme member
- External benchmarks

Economies of Scale

- Larger schemes incur lower costs
  - Lower annual management charges (both insured and non insured);
  - Higher allocation rates (insured schemes);
  - Lower policy fees (insured schemes);
  - Greater instance of employers meeting the cost of policy fees (insured schemes);
  - Less prevalence of exit penalties (insured schemes).

Legacy Charges

- Level of occupational schemes with legacy pricing structures is small (80% last 5 years)
- Lower level of review in individual pension arrangements (RAC <50%; Exec. plan <60%)
- Buy out bonds – little variance
- PRSAs – charges prescribed. Max rate prevalent
- ARFs – little variance
- Annuities – no direct costs – commission only

Commission

- Fee agreements are a particular feature of DB schemes. Commission prevalent in 13% of schemes.

- Commission is prevalent in 39% of DC insured schemes compared to 7% in DC non-insured schemes. Commission is more prevalent in scheme of less than 50 members.

- Commission is particularly common and vary significantly within RACs and Executive Pension Plans.

•Approximately 25% of new RACs and Executive Pension Plans, set up in 2010, were based on maximum (25%) commission terms and approx. 5% were created on a nil commission basis.

- Where initial commission is evident, it is typically at levels of up to 25% of first year's contributions (and any increases in premiums thereafter). Renewal commission payments of between 1% and 5% of annual contributions are also a common feature.

- A typical commission payment for a BOB or an annuity is 2% of contributions.

- Commission terms of between 0 and 5% of contributions are common for ARFs . 3% commission most prevalent.

Employer costs

- Employers generally cover full costs in a DB scheme.
- Employer covers a higher level of costs in a DC non-insured scheme than in a DC insured scheme.
- Typical costs include:
  - Pension consultancy costs – professional pension advice to sponsoring employers / trustees;
  - Statutory reporting requirements - Trustee Annual Reports and Financial Statements;
  - Member communication / support – such as member presentations, one to one advisory meetings etc.;
  - Audit fees – i.e. a specific regulatory requirement where a scheme membership is in excess of 100 members;
  - Professional trustee costs – where a professional trustee is appointed as trustee to a scheme;
  - Legal fees – legal opinion provided to sponsoring employers / trustees relating to specific pension issues.

External benchmarks

- Using the average RIY across the various sizes of DC scheme, these scheme compare favourably with the typical charging structure for PRSAs and with the UK Stakeholder Pension scheme.
- Average Reduction In Yield ranges:
  - DC schemes 0.45% to 0.95%
  - UK Stakeholder 1% to 1.63%
  - PRSAs 1.2% to 1.57

External benchmarks

- DC schemes did not compare favourably with the new NEST pension scheme which has an equivalent RIY of 0.41%
- NEST benefits from economies of scale and investment from UK Government.
- Individual pension arrangements (RACs and Exec plans) did not compare favourably with either PRSAs or the UK stakeholder scheme. The RIY for RACs and Exec plans ranged from 1.18% to 1.97%

Transparency- Regulatory overview

- Different structures for occupational pensions and individual pensions
- Regulatory gaps in occupational regulations
- Need consistency between occupational schemes and individual arrangements
- 2012 Central Bank Consumer Protection Code introduced significant changes
- EU Directives concerning transparency being reviewed (IORPS, PRIPs, MiFID II and IMD2).

Transparency Research

- 63% of trustees had difficulty obtaining some of the information required for the research (included some professional trustees)
- Research did not include individual policy holders
- Review by Group of individual policy communications issued pre and post policy agreement
- Pre policy agreement: information illustrative and confusing,
- Post policy agreement: in general no information on charges provided
- Role of the 2012 Consumer Protection Code addresses this
- **Transparency driven by regulation, no culture of providing information on charges, no clear link to service being provided, “bundling” of costs, multiplicity of charging types**

Report Conclusions

- Individual pensions expensive
- Occupational pensions can be reasonable, but research indicates only engaged trustees responded, trustees not “aware” of charges
- Strong economies of scale evident
- No culture of transparency, poor communication
- Consumers not aware of the significant impact charges have on pensions

Report Recommendations

- Improve consumer, employer and trustee awareness and knowledge
- Address regulatory gaps
- Re-brokering – examination needed to ensure it is not detrimental to the member
- Monitor EU developments
- Auto enrolment a potential response
- Multi agency approach needed
- Review data

Post Charges Consultation

- Industry – Overestimated costs, value for money, occupational v individual, welcome improved disclosure/transparency, regulatory costs
- Consumer – Understates costs, low compliance, poor understanding of remuneration, tiered charges/turnover, DB employers, market failure & information asymmetries, improved regs

Post Charges Report

- PA website information on charges. Trustee training and handbook being updated.
- Central Bank – CPC & themed review of annual statements/ sales incentives and remuneration policy/ Re-brokering and intermediaries.
- Revision of IORPS Directive – Deferred members/trustee & competencies/risk

Post Charges Report

- Pensions Reform and Simplification
  - Improved disclosure requirements
  - discontinue BOB and RAC’s
  - Smaller number of larger occupational schemes
  - higher standards for smaller number of Trustees

Post Charges Report

- Universal Retirement Savings Group &
  - TOR consideration of maximum charges, a ban on certain charges, transparency and/or publication of all charges, including on a central location
- Single measure of cumulative charges? ad valorem, fixed and contribution charges??
- ASI data on charges could be collected through PA