B&CE response: The Occupational and Personal Pension Schemes (General Levy) review 2019: public consultation

About us

B&CE is the provider of the People's Pension, a not-for-profit master trust which delivers a workplace pension to more than 4.7 million mostly low and medium income savers. The assets of The People's Pension exceed £8bn. B&CE is a not-for-profit provider of straightforward financial products, founded by construction industry employers and trade unions in 1942. We have recently completed the transfer of nearly half a million customers from our legacy contract based DC arrangement to The People's Pension master trust because of the higher governance standards and lower charges of the latter.

Introduction

The consultation document refers to the General Levy having not increased in recent years. This is not true in the case of The People's Pension (TPP) nor at the aggregate level. Auto-enrolment (AE) is a small pot creation machine and the levy is calculated per member. Based on DWP estimates of dormant pots, we anticipate £9.75 million is currently being raised from dormant pots, a figure that is anticipated to increase[1]. Thus, the levy is structured to ensure that every year it raises more money. With no policy change, TPP anticipates a 90% cumulative increase in our levy payment between 2018/19 and 2022/23, an increase of £1.6m. These factors help explain why 10 DC schemes, mainly serving the automatic enrolment market will pay a quarter of the total general levy next year, even with no increase in the levy rate. They will pay 25% despite holding just 2% of occupational pensions sector assets.

They will pay 25% despite their members including millions of low earners in high turnover sectors who have small pension pots. The per member structure of the general levy made sense in a world of long- term employment, where a smaller proportion of the workforce had access to workplace pension saving. Automatic enrolment has brought in a new group of people who are typically much younger, have lower earnings and move from job to job much more frequently. It seems unfair that they carry the heaviest regulatory burden.

Beyond this unfairness, the rising costs of regulation which the consultation document refers to, demand further explanation than so far offered by the government. In terms of AE, the heaviest costs lie in ensuring employer compliance with AE staging. But staging is over. This combination - of lower AE regulatory costs now all employers are in, and a levy structured to raise more money every year as small pots proliferate - makes the need to raise even more money hard to understand. At least without a proper explanation.

We favour an immediate review of the structure of the General Levy, oppose the 10% hike proposed in the consultation document, and believe that for transparency purposes, a breakdown of regulatory costs by pensions sector (DB/DC/AE) should be undertaken.

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[1] See Annex 1.

Key issues

By 2020/21 c. 10 % of the total running costs of the B&CE group will be accounted for by a combination of the general levy and the fraud compensation fund levy. This is before one considers the huge deficit which we understand has opened up in the funding of the fraud compensation levy and the costs of pensions dashboard(s) – both of which we understand will be passed on to the industry to fund. Within the B&CE group, by 2020-21, The People's Pension will pay nearly 7 per cent of the total general levy as it is currently calculated from an asset pool of just £8bn.

Auto-enrolment is a small pot creation machine, characterised by high rates of job churn, lower earnings and high rates of retention. This is leading to a ballooning number of small pension pots, each of which generates a levy payment. As churn is faster at the lower end of the labour market, something observable from the differential between the People's Pension's churn data and the same data for the eligible group a whole, the proportion of the levy sourced from the pension pots of the lowest earners rises inexorably over time. Churn (members becoming deferred) in The People's Pension is close to 5 per cent per month, in contrast to the group eligible for AE as a whole, where churn is close to half that figure. Estimated median earnings for members of the People's Pension are £20,744 while median estimated earnings for NEST members are £18,656 per annum. This is about £10,000 below median full-time earnings in the UK.

Why should these members with small pension pots carry the heaviest levy burden? Compare roughly what The People's Pension pays versus USS the largest pension fund in the UK. On assets of £60bn and with 450,000 members USS would pay c. £390,000. We will pay £2.9m. Ultimately all expenses incurred by The People's Pension come from members. As a not for profit we have no shareholders who might enjoy a reduced dividend as a result of increased levy costs. Furthermore, Government policy is to encourage competition in the small pots mass AE market – the current levy system undermines competition by loading costs onto the few providers in this market.

It is uneconomic to have to pay regulatory fees on such small pots and is not commensurate on the risks they present. Yet there is no policy solution on the horizon to the small pots problem. As such, an immediate and urgent review of the General Levy's per member calculation method should proceed any increase in the levy.

Question responses

Question 1

Which option do you prefer?

We disagree with the options presented in favour of an immediate and urgent review of the fairness of the per member levy. We note that option four contains no immediate increase in the levy suggesting that such an approach is possible.

Question 2

In respect of your answer to Question 1, why do you support your preferred option?

The general levy is no longer fit for purpose. Schemes serving the new savers brought into pension saving by automatic enrolment pay a disproportionate amount of the total levy. B&CE anticipates paying around £2.9m in 2020/21 (assuming no policy change) out of a total of c. £43.5m in anticipated levy revenue. This is just under 7 per cent of the total levy revenue on around half of one per cent of the occupational sector's total asset base. Together with the FCF levy, the B&CE group anticipates general levy payments totalling 10 per cent of group running costs by 2020/21.

One reason for this is that members move job faster at the lower end of the labour market. Churn in TPP is close to 5 per cent per month (or roughly 235,000 members), in contrast to the group eligible for AE as a whole, where churn is close to half that figure. TPP generates around 17-18,000 sub £200 pots per month, despite our system reconnecting people who re-join TPP with their pre-existing pot. When the situation beyond TPP is considered, our members are more likely to have multiple small pension pots than individuals with higher earnings and as such they are more likely to be paying the levy multiple times over, once per pot. We explore the reasons and impact of this in more depth in annex 1 of this response.

If the calculation method is unfair, there are also unanswered questions about the rising regulatory bill. In 2012, TPR was able to provide an activity breakdown to the NAO, suggesting that in the past year 22% of its activity related to the regulation of DC pensions. That was anticipated to rise to 32% the following year. It was not clear, though, what proportion of this activity relating to DC pensions was tied to levy spending and what proportion was tied to the regulation of AE and was tied to funding from DWP[2].

Subsequent iterations of TPR's annual report showed details of activity, e.g. the number of DB cases opened but did not show a proportionate activity breakdown. They also did not show an activity breakdown between regulatory activity pertaining to DB and DC pensions, a spending breakdown between the different sectors and the split between activity funded by DEL and that funded by the levy. TPR has scaled back its disclosure of regulatory activity and the annual report and accounts is now a shorter document with less detail about TPR's activity.

Any future review should be informed by high quality information about how the three bodies funded by the levy deploy levy revenue. So far, the debate about the fairness of the levy has not been informed by high quality information about how the money is spent and the degree of cross subsidy which exists - for instance, DC savers subsidising the regulation of DB benefits is widely suspected but unconfirmed.

Question 3

Would you like to propose any alternative option(s) to those set out in this consultation which would eliminate the levy deficit? If so, please provide details.

A review of the levy is the best way forward. A review would allow for a full reform of the levy and would allow for the time required to develop consensus on the future levy structure. That means settling on a series of principles that might underpin the design of a future levy. We think that it will be through achieving consensus on the principles that should underpin the design of the levy that we are most likely to reach a solution that most schemes can support.

The following principles would, potentially, act as a basis against which to judge future levy structures:

1. Provide a stable revenue stream for MaPS, TPO and TPR
2. Place bounds on cross subsidy. Cross subsidy is an inevitable feature of levies and is in some cases desirable. But it should be limited.
    a. The costs of "greater good" regulation should not fall disproportionately on any one group of levy payers.
    b. Schemes should generally fund the regulation of the benefits they offer.
3. Should be consistent with government policy for the pensions market. It should not focus on any one market sector. It should not create perverse commercial incentives.
4. The levy should be reviewed regularly to ensure consistency with the above principles.

We hope that a review would be open to a wide assessment of possible alternative levy models consistent with these principles. That could include some form of asset based levy, indeed this approach is used in other countries, including Australia. It could potentially include some form of re-banding of the levy, which could

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[2] https://www.nao.org.uk/wp-content/uploads/2012/07/1213466.pdf

include the removal of small pots from the calculation. It could also be possible to try and hypothecate the levy such that the costs of regulating DB and DC are separated and paid for separately.

We have no preferred solution at this time and are keen to explore any solution consistent with the principles we have outlined above. Our comments here are intended to spur a discussion and indicate a desire for the broadest reasonable approach to reforming the levy.

Question 4

Do you agree/disagree that we should increase the fixed levy contribution for small schemes with 2 to 11 members? Please give your reasons.

No response.

Question 5

What is the impact to your scheme of raising the levy? How will your scheme respond to a levy increase? (For example: would it be absorbed by scheme, passed on to members, or employers?)

Table 1 shows our anticipated levy increase both with and without the 10 per cent increase in the levy rate included within option one.

Table 1: Impact of General Levy on TPP under different levy options and with no policy change

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
Current Levy	£2.5	£2.9	£3.2	£3.4	£3.7	£3.9	£4.1	£4.2	£4.4	£4.6
Option 1	£2.5	£3.1								
Option 2	£2.5	£4.1	£7.2	£11.9						
Option 3	£2.5	£3.6	£4.6	£5.7	£6.8	£8.0	£9.2	£10.4	£11.7	£13.0
Option 4	£2.5	£2.9	£4.2	£5.3	£6.6	£8.0	£9.4	£10.8	£12.3	£13.9

Note: for options 1 and 2, it is not known what the levy rates or structure will be for later years in the table.

From the table in paragraph 52, it seems that DWP anticipate raising an additional £1.3m in the 2020/21 levy from occupational DC schemes. Based on our calculations, we would expect roughly 20 per cent of this £1.3m to come from TPP, or, about 5.5% of the additional £4.6m that you anticipate raising from the levy overall.

Overall, TPP paid about 4 per cent of the total levy in 2018/19. Given that DWP anticipates little or no rise in the levy over the forecast period without policy action, we anticipate that proportion rising to just under 7 per cent in 2020/21 without a 10 per cent increase in the levy rate and c. 6.5% with the 10 per cent increase in place. Absent policy action we anticipate our levy payment growing over time such that TPP would account for an increasing proportion of the overall levy over time.

We are a trust based non-profit scheme. Ultimately all expenses incurred by the scheme come from members. There are no shareholders who might enjoy a reduced dividend as a result of increased levy costs.

Question 6

If you were to consider passing on costs to employers to absorb the levy increase, what is the size composition of employers using your scheme? (For example: are they mainly small, with less than 50 employees or larger employers?)

This policy option should not be explored further, at least not in relation to employers using DC schemes to fulfil their automatic enrolment duties. Government, TPR and the pensions sector have asked a lot of employers since 2012. Compliance with automatic enrolment regulations has been difficult and financially burdensome for many.

At a time when Government is proposing to increase statutory minimum contributions by removing the lower qualifying earnings band, we think it would be unduly burdensome to apply the levy to employers.

The policy case for raising the levy on employers sponsoring DB schemes could well be different. We are not in a position to comment on what is appropriate for employers sponsoring DB schemes.

Annex 1: Dormant and small dormant pots

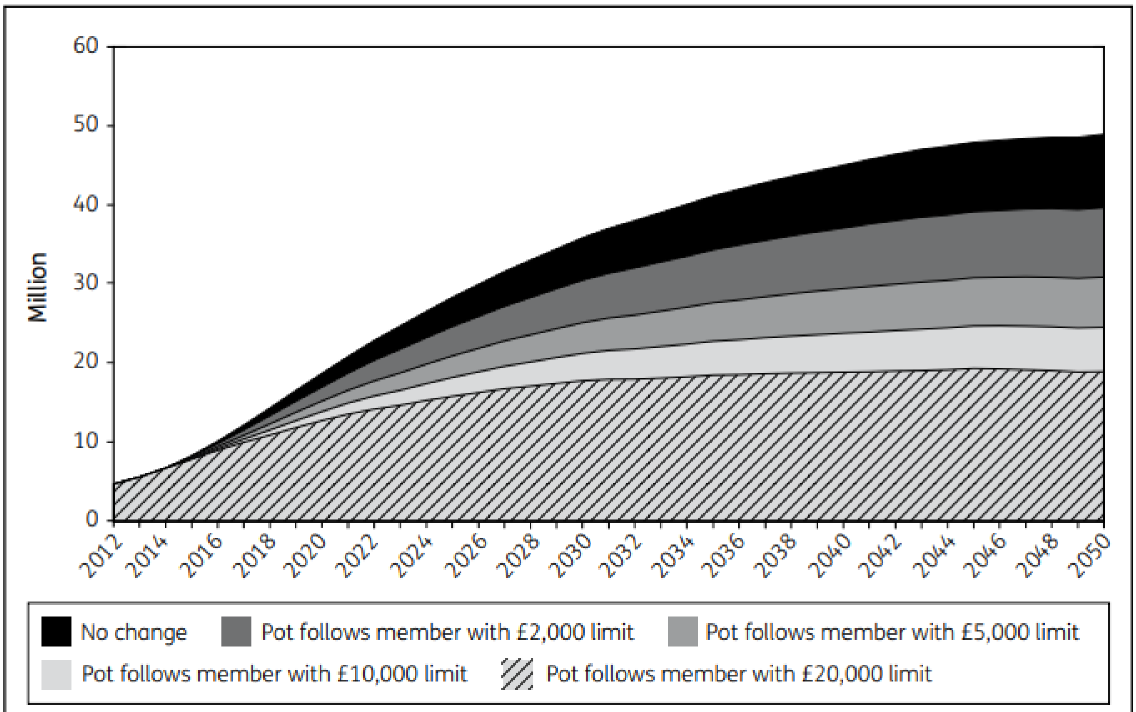
The chart below is taken from the DWP publication "Automatic transfers: consolidating pension savings". It shows the proliferation of small pots within the Department's PENSIM 2 model under a variety of policy scenarios including no policy action.

As can be seen, the model forecast c. 15m dormant small pots at the present time, rising to 50m dormant small pots at the end of the model run. Given that the level of churn in TPP' membership is roughly double the churn rate shown in the DWP's 2018 RTI analysis of churn in the population eligible for automatic enrolment, it is possible that both the 15m and 50m figures are underestimates.

This suggests that a considerable but unknown proportion of the levy is being raised from dormant DC accounts. If we accept 15m as a low end estimate, notwithstanding our concerns about PENSIM 2's job churn variables, then the lowest level of income in the system at the moment that might be derived from dormant pots is 9.75m (based on the 65p rate for 500,000 plus schemes). Without structural change to the levy, this will rise to a minimum of 32.5m by about 2046.

Figure 1: Growth of small pots estimates used to inform the automatic transfers project

Figure 1: Projected total number of dormant pots where the pot follows member from job to job[13]



Source: PENSIM2.

Source: DWP

In terms of the impact on The People's Pension, the table below shows the number of small pots, in this instance below £350, we have – both active and deferred. We have just over 1.3m pension pots below £200. With our 50bps charge, a £200 pot generates £1 in revenue – so 10p in excess of the charge level required to pay the FCF and general levies. Were the levy raised tomorrow, we would pay c. £851,000 on these pots.

Table 2: small pots

Range	Total Policy	% Membership
<£100	839,262	17%
£100-£200	470,538	10%
£200-£300	335,499	7%
£300-£350	130,649	3%
Total	**1,775,948**	**37%**

While we believe that our internal costs are lower than comparable master trust pension schemes, the revenue on small pots is far below the level required to pay the full cost of administering the pot. To some extent, this is an inevitable part of the automatic enrolment business model – it will take time for small pots to grow and for master trusts like The People's Pension to achieve scale. But it is inevitable that there will be a considerable number of small dormant pots and it should not be assumed that all small pots will grow – as the Australian example demonstrates. The demands being placed on The People's Pension in respect of the levy are now very heavy in proportion to revenue that might be reasonably derived from the book.