



Building Personal Accounts: Choosing a Charging Structure

Xafinity Paymaster's consultation response, April 2008



We are delighted that the personal accounts delivery authority (PADA) has involved us in the consultation on personal accounts. People want and need a simple low-cost solution to retirement saving and we remain convinced that this can be achieved by using existing technology and pension expertise.

The charging structure for personal accounts needs to be fair and sustainable. We believe that the best mechanism is a **contribution charge and an annual management charge (AMC) with an element of capped charge**.

A similar approach has just been adopted by the Premium Pensions Scheme (PPM) in Sweden as it is the fairest approach for members.

Chief Executive Officer, Xafinity
Tim Robinson

Xafinity Paymaster

Xafinity Paymaster is one of the UK's largest financial business process outsourcing companies, providing pensions administration, payments and collections services for hundreds of public and private sector organisations. Founded in 1836, Xafinity Paymaster has an unparalleled 170 years' experience in large-scale financial administration. Over 2 million members throughout the world rely on Xafinity Paymaster to pay their pensions, with transaction values exceeding £7 billion every year.

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I Executive Summary



1.1 Introduction

One of the main aims of personal accounts is that the scheme is low cost. The best way to achieve this aim is to ensure that the charges levied against each account are as low as possible. While consumers may not be interested in the charging mechanism they will be interested in the actual amount of money they have paid in charges.

The job for PADA is to devise a mechanism which achieves the lowest possible charge for members and this may not be a simple mechanism because of the many complexities of the scheme. Nevertheless, the mechanism will need to be described in a way that people can easily understand.

The charging mechanism for the personal accounts scheme will need to cover all the running costs associated with the scheme. These costs include:

- Administration costs.
- Set-up costs.
- Investment management costs.
- Trustee costs (Personal Accounts Board, the Pension Regulator levy, marketing costs).

The key complexities associated with deciding on the mechanism are:

- Different elements of the scheme costs may suit different charging mechanisms; and
- Some members will have very small pots and/or contribute very small amounts.

Added to this is the further confusion around terminology e.g. around AMC. We are using the term AMC in its broadest sense i.e. a % of the pot.

It is our view that a combination of a [contribution charge and an AMC with an element of capped charge](#) is the best mechanism for ensuring that each member pays the lowest possible charge.

The following example is based on a 5% contribution charge (capped) and 0.25% AMC (partially capped). It may be possible to cap more of the AMC but this depends on how other elements of the running costs are paid for; primarily the investment management costs.

Each month the charge for administration would be levied at the rate of 5% of each contribution and 0.1% of the pot. At the point at which this overall charge reached a pre-determined amount (e.g. £2) then the charge would be capped. The other portion of the AMC (0.15%) would be levied without any cap.

1.2 Merits of our proposed charging structure

This charging structure is:

- **Fair:** the capping of costs ensures that higher contribution and fund levels do not mean more costly administration. At the same time, those with small contributions or small account values will be protected against disproportionate charges eroding their savings.
- **Sustainable:** the contribution charge element of this mechanism brings in more in the early years, when the fund charge contributes very little. The effect of this combination is to align revenue with the cost of administration, so requiring less adjustment in later years than alternative charging structures being considered.
- **Based on well established mechanisms in the UK:** for occupational pension administration the established mechanism for charging is a per capita flat fee. The mechanism we are proposing is a quasi-flat fee.
- **Closely aligned with mechanisms for similar schemes:** the charges for KiwiSaver are based on a fixed monthly flat fee (typically NZ\$3) and an AMC. The PPM scheme in Sweden introduced a cap on administration charges of SEK 100 (c. £8.50) in May 2007. This works in combination with an AMC for fund charges.
- **Encourages further saving:** at some stage, the emphasis for the scheme may shift towards encouraging savers to contribute more into their personal account; a mechanism which caps the contribution charge will be fairer as well as making higher contributions more attractive.

1.3 Consultation response

A summary of our response to the consultation questions is given below:

Question	Xafinity Paymaster Perspective
1. How should the principles of the personal accounts delivery authority relate to the charging structure recommendation, and in what way should the principles best be applied in this context?	In our view, the mechanism which best applies the principles of the personal accounts delivery authority is a contribution charge and an AMC with an element of capped charge.
In relation to charging in the financial services industry:	
2. What are the charging structures currently used by the financial services industry, both for pensions and other financial products?	The industry in the UK uses an array of charging mechanisms encompassing all the proposed charging options. There are good international and UK examples of similar mechanisms to the one we are proposing.
3. What are the rationales for these charging structures, and which of these rationales are relevant to personal accounts?	Generally, charging structures attempt to match revenue with costs. The advantage of the mechanism we are proposing is that it is both fair and sustainable.
In relation to the charging structure options:	
4. Are there any other charging structure options that might be suitable for personal accounts that are not included in this document?	We believe that a contribution charge and an AMC with an element of capped charge is the best mechanism.
5. Should additional charges be made for particular scheme activities?	Yes, we believe that certain activities justify specific additional charges.
6. What activities could members reasonably expect to pay more for; what activities could administrators reasonably expect to charge for; and why?	Activities which are required by a minority of members and where the actual cost of administration is high: <ul style="list-style-type: none"> • Pension sharing on divorce • Additional statements • Frequent investment switches
In relation to our evaluation criteria:	
7. Are these evaluation criteria appropriate?	Yes.
8. Which evaluation criteria do you think are most important for personal accounts and why?	Retirement outcome for members and sustainability. If the charging mechanism is fair and sustainable it is most likely to contribute to the success of personal accounts.
9. Are we missing any criteria that might be relevant?	When considering sustainability there is a need to ensure that the mechanism matches revenue with cost as closely as possible. If there is not a close match there will be significant challenges for the Trustees of the scheme.
In relation to member outcomes:	
10. How should we assess the impact of different charging structures on member outcomes, and why?	By modelling the total amount lost to charges. This provides a clear and absolute comparison, compared with modelling the reduction in investment returns, which can be obscured by different investment funds having different growth rates and AMC percentages.
In relation to participation in the personal accounts scheme:	
11. What is your experience of the effects of different charging structures on the perceptions of consumers?	Our experience is that it is important charges are transparent and seen to be both fairly applied and a fair reflection of the cost of administration.
12. What evidence is there about how consumers' perceptions affect participation in pension schemes or other financial products?	Other factors, such as affordability, will have a far greater impact on participation.
In relation to minimising scheme cost:	
13. What evidence is there about the way in which administrative complexity or member behaviour have affected costs in existing financial products?	Added complexity deters people from making full use of available options: it pays to keep things simple.

2 Introduction



2.1 Background

In response to the Turner Report¹, we issued a paper titled "National Pensions Saving Scheme – The Paymaster Perspective". At the time of publication there had been a great deal of debate in the industry about whether the personal accounts scheme could be delivered at a low AMC.

Based on our experience of delivering large scale pension administration services, particularly the experience of collecting contributions from a large number of employees via employers in the NHS Pension Scheme and having conducted detailed modelling, we argued that a low AMC could be achieved based on an optimum scheme design².

Since then we have been working with DWP and PADA and we have met with other stakeholders and pension industry representatives to build on this perspective. We remain convinced that Lord Turner's vision is achievable.

2.2 Scope of This Paper

This paper builds on our initial perspective and is our response to the PADA charging consultation document "Building Personal Accounts: Choosing a Charging Structure".

2.3 Our Credentials to Comment

2.3.1 Pension Scheme Administration

Xafinity Paymaster is one of the UK's leading pension administrators providing pension administration services to over 2 million pension scheme members. This has enabled us to develop best practice approaches to all the activities required in administering the personal accounts scheme and to analyse the establishment of the scheme.

2.3.2 Contribution Collection & Handling

We provide contribution collection services to our many pension administration clients including the NHS Pension Scheme which has an active membership of approximately 1.3 million people. We collect contributions from the NHS employers (in England & Wales), perform contribution reconciliation and associated membership record management. We deal with over 11,000 employers varying in size from the biggest NHS Trust to the smallest GP Practice.

¹ Pensions Commission Second Report

² National Pensions Saving Scheme – The Paymaster Perspective

3 Charging Consultation Response

1. How should the principles of the personal accounts delivery authority relate to the charging structure recommendation, and in what way should the principles best be applied in this context?

The table below summarises our views on how the principles of the personal accounts delivery authority should be applied in relation to the charging structure recommendation:

Principles	Applied To Charging Structure
Participation in qualifying schemes should be encouraged & facilitated	Evidence ³ suggests that none of the charging mechanisms under consideration for personal accounts will directly inhibit participation. Other factors, such as affordability, will have a far greater impact on participation. Nevertheless, it is important that the charges are transparent and seen to be both fairly applied and a fair reflection of the cost of administration, as any negative publicity about the charging is likely to have some impact on participation. A contribution charge and an AMC with an element of capped charge can be presented as fair so should not inhibit participation.
The burdens imposed on employers should be minimised	Employers will already have to bear the cost of contributions and any administration costs associated with enrolment, maintaining accurate records and submitting contributions. The charging mechanism should not place any further burden on them.
Any adverse effects on qualifying pension schemes, and members and prospective members of those schemes, should be minimised	Our suggested charging structure is broadly aligned with those of pension plans and other financial products generally and we see no reason why existing qualifying schemes would be impacted, either positively or negatively.
The cost of membership should be minimised	Whichever charging mechanism is chosen should lead to the lowest possible absolute charges. It should minimise finance costs and any costs associated with collecting the charges. This also means matching the administrator's revenue as closely as possible to costs in order to avoid under or over recovery of costs. A contribution charge and an AMC with an element of capped charge will minimise the cost of running the scheme as it is easy to collect and it provides a good match between cost and revenue, therefore avoiding under or over recovery.
The preferences of prospective members should, so far as practicable, be taken into account in making any provision about investment choice for personal accounts	The relevance of this principle, when considering charging mechanisms, relates more to the investment products and their associated charges. We expect that there are likely to be variable AMCs associated with different investment products.
Diversity among members and prospective members of personal accounts should be represented.	Our mantra is to keep the costs as low as possible for all members which can best be achieved via the mechanism we are proposing.

³ Personal accounts: Attitudes & reactions to possible charging structures

In relation to charging in the financial services industry:

2. What are the charging structures currently used by the financial services industry, both for pensions and other financial products?

International examples

Sweden: The PPM scheme was launched in 2000. Initially the cost for administration of the scheme was charged on a pure AMC basis. Last year a decision was taken by parliament to cap the cost of administration at SEK 100 (c.£8.50). This decision was not controversial in any way.

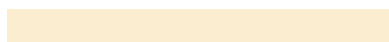
PPM Fee charged per year									
Conversion between SEK (Swedish Kronor) and GBP (Pounds Sterling) using exchange rate on 4/4/08									
Rate GBP/SEK 11.92									
Year	Percent	Cap		Total fees		Accounts	Average fee		
		SEK	GBP	MSEK	MGBP		SEK	GBP	
2001	0.30%	N/A	N/A	262	22.0	4,898,126	53.49	4.49	
2002	0.30%	N/A	N/A	234	19.6	5,082,834	46.04	3.86	
2003	0.30%	N/A	N/A	242	20.3	5,226,356	46.30	3.88	
2004	0.27%	N/A	N/A	331	27.8	5,344,133	61.94	5.20	
2005	0.22%	N/A	N/A	335	28.1	5,455,252	61.41	5.15	
2006	0.16%	N/A	N/A	370	31.0	5,555,420	66.60	5.59	
2007	0.16%	100	8.39	380	31.9	5,672,766	66.99	5.62	
2008	0.16%	100	8.39	375	31.5	5,823,607	64.39	5.40	
Note: the figure for 2008 is an estimate									

New Zealand: For KiwiSaver providers, it is standard practice to charge a monthly member fee and an AMC.

This tariff is an extract from AMP's fact sheet for their KiwiSaver product:

Current Charges – Summary

- \$3 per month Member Fee
- 0.350% or 0.525% per year Administration Fee
- Annual Management Fee that varies depending on the Fund(s) in which your contributions are invested
- Transaction costs



Occupational pension schemes

For occupational pension schemes the standard charging mechanism is a flat annual charge per member and there are usually different charging levels for active, deferred and pensioner scheme members.

The tariff table below is an extract from a recently received Invitation to Tender (ITT) for pension administration. This demonstrates that flat charge is well established as the norm for pension administration.

Please complete the cost table below. We have requested costings based on a per member pricing arrangement in order that costs can easily be compared.

	Unit Cost	Fee (£)
Annual scheme charge		
Variable cost based on a per member charge		
Actives (5,253)		
Deferreds (18,118)		
Pensioners (26,005)		
Other services		
Total		

Other financial services products

There are other UK financial services products which use a combination of annual charge and AMC.

This is an extract from Selftrade's ISA charges:

Pricing

- £12.50 - our flat fee for online and phone trades
- Applies across all of our different accounts.
- No dealing fee on Fund purchases
- Plus many Funds have specially negotiated initial charges and lower management fees to save you even more.
- Flat rate account fee of £25 p.a.
- Covers the account fee of the PEP too.

Note: fund management charges are additional & on an AMC basis



3. What are the rationale for these charging structures, and which of these rationale are relevant to personal accounts?

International examples

Swedish PPM scheme: the reason the cap was introduced was because it was not considered to be fair to charge a large amount of money for someone who has a large pot since the running cost is basically the same for everyone in the scheme.

However they did not want to charge a flat fee for people who have a very low value in their account as it would not be fair to charge SEK 100 to someone who only has, for example, SEK 300 in their account.

New Zealand KiwiSaver providers: the rationale for the element of flat fee partly relates to the fact that the Government is paying NZ\$40 a year per account to cover running costs, so the flat monthly fee aligns well with this approach.

Occupational pension schemes

The rationale for the standard flat fee charging mechanism for pension administration is that it is the mechanism which best matches the costs associated.

The cost of administration is directly related to the number and type of pension scheme members (not the level of contributions or the size of the fund). Activity analysis enables assessment of the cost of administration which is translated into a cost per member per annum taking into account any scheme specific factors.

Relevance to personal accounts

For personal accounts the cost of administration is also going to be related to the number of contributing and non-contributing members (not the level of contributions or the size of the fund). In our cost modelling we have used activity analysis, based on our experience and other relevant information, which gives us a good indication of the likely costs of administration.

We believe that the best way to recover these costs is via a quasi-flat fee (a capped administration charge) as it is closest to the existing well-established method used for pension administration and enables a close match with the costs of administration.

In relation to charging structure options:

4. Are there any other charging structure options that might be suitable for personal accounts that are not included in this document?

We believe that a contribution charge and an AMC with an element of capped charge is the best mechanism.

5. Should additional charges be made for particular scheme activities?

There is a good case for additional charges for particular scheme activities and there is good precedent for this. In our first paper⁴ which we published in April 2006, we made the case for additional charges for certain activities and we remain convinced that this is still a good approach.

We see additional charges as an important element in keeping the basic scheme simple: in both substance and presentation it can be seen as a "clean" scheme with add-ons. Additional charges also minimise cross-subsidisation of charges and encourage people to stick to the basics.

⁴ National Pensions Saving Scheme – The Paymaster Perspective

In relation to our evaluation criteria:

6. What activities could members reasonably expect to pay more for; what activities could administrators reasonably expect to charge for; and why?

We believe that members could reasonably expect to pay more for the following activities:

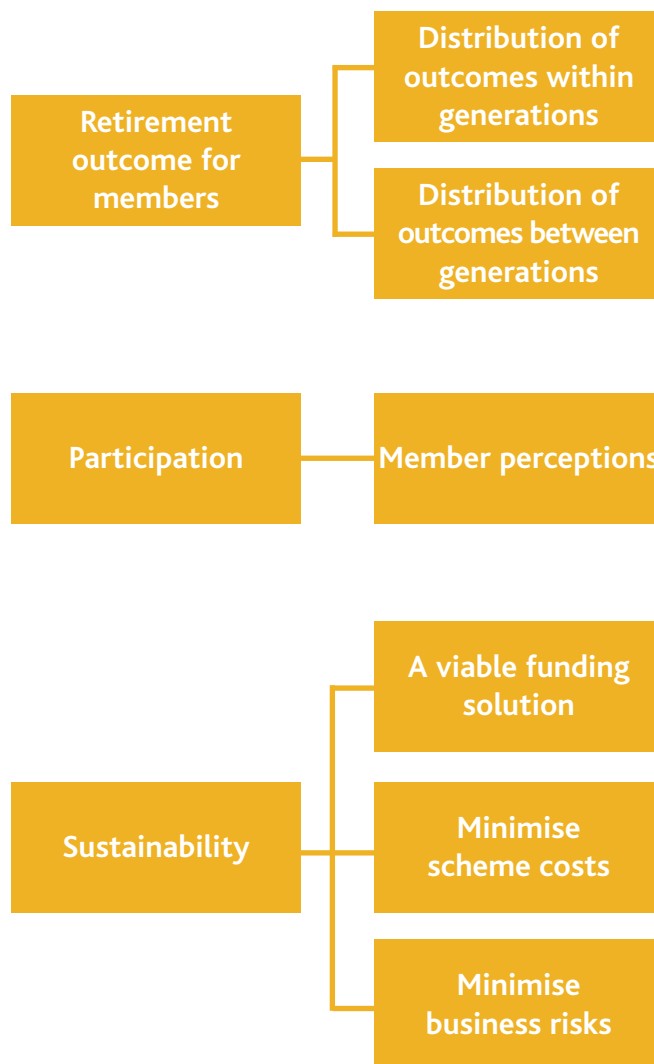
- Pension sharing on divorce: it is industry practice to deduct a fixed charge from the fund.
- Additional statements: on-line statements will be available for members to download, so it seems fair that if members require additional statements sent via post that they should pay for the associated cost.
- Frequent investment switches: we recommend that a certain number of switches (perhaps two) per year should be included in the administration charge. For members who wish to make more switches then there should be charge to cover this cost.

Fidelity Life's fact sheet for their KiwiSaver product shows within their fee structure:

Investment fund changes: 1 per year free, \$60 for each additional change

7. Are these evaluation criteria appropriate?

Yes, we believe that the evaluation criteria below (taken from the discussion paper to support the consultation) are appropriate.





8. Which evaluation criteria do you think are most important for personal accounts and why?

Our view is that **retirement outcome for members** and **sustainability** are the most important criteria for personal accounts.

Retirement outcome for members: The charging mechanism must be as fair as possible.

Sustainability: The charging structure must support the administration in the early years, but should at the same time provide a stable charging platform which does not discriminate unacceptably between generations.

It is also best to avoid regular changes to the charging structure. A commitment to retain a structure over the long term could well raise participation rates and encourage further saving.

9. Are we missing any criteria that might be relevant?

When considering sustainability there is a need to ensure that the mechanism matches revenue with cost as closely as possible. Otherwise there will be significant challenges for the Trustees of the scheme.

In relation to member outcomes:

10. How should we assess the impact of different charging structures on member outcomes, and why?

We believe the best method of assessing the impact of various charging structures is to model the total amount of the saver's account which has been lost to charges. This method provides a clear and absolute comparison, compared with modelling, for example, the reduction in investment returns, which could be obscured by different investment funds having different growth rates and AMC percentages.

In relation to participation in the personal accounts scheme:

11. What is your experience of the effects of different charging structures on the perceptions of consumers?

For the trust based schemes where we provide pension administration the charges are paid for by the employer and the consumers (scheme members) are not aware of the charging structures.

12. What evidence is there about how consumers' perceptions affect participation in pension schemes or other financial products?

Other factors, such as affordability, will have a far greater impact on participation. Nevertheless, it is important that the charges are transparent and seen to be both fairly applied and a fair reflection of the cost of administration, as any negative publicity about the charging is likely to have some impact on participation.

In relation to minimising scheme cost:

13. What evidence is there about the way in which administrative complexity or member behaviour have affected costs in existing financial products?

The key to success will be the ability to automate processes through standardisation, and hence reduced cost. Exceptions to the standard process will generate cost. We have recommended ways in which complexity, and therefore cost, can be minimised. This is a product for people who have not been engaged by the industry so far – there is no need to offer them the complex levels of choice available in some financial products.

Evidence of this is our own experience of what happens when occupational DC schemes offer a wide range of funds plus a default Lifestyle option. More than 85% of joiners opt for the default and never make any future change.

4 Conclusion



The personal accounts scheme remains the best solution to the problem of under saving for retirement in the UK. It is our view that with pragmatic design and good promotion the scheme will be successful and low cost as Lord Turner envisaged.

The charging structure for personal accounts needs to be fair and sustainable. We believe that the best mechanism is a [contribution charge](#) and an [AMC with an element of capped charge](#). This is the approach which best aligns with the costs of running the scheme and it also the fairest approach for members.

This paper is a summary of detailed work carried out by Xafinity Paymaster. For more information on any aspect of this paper please contact clare.ward@xafinitypaymaster.com

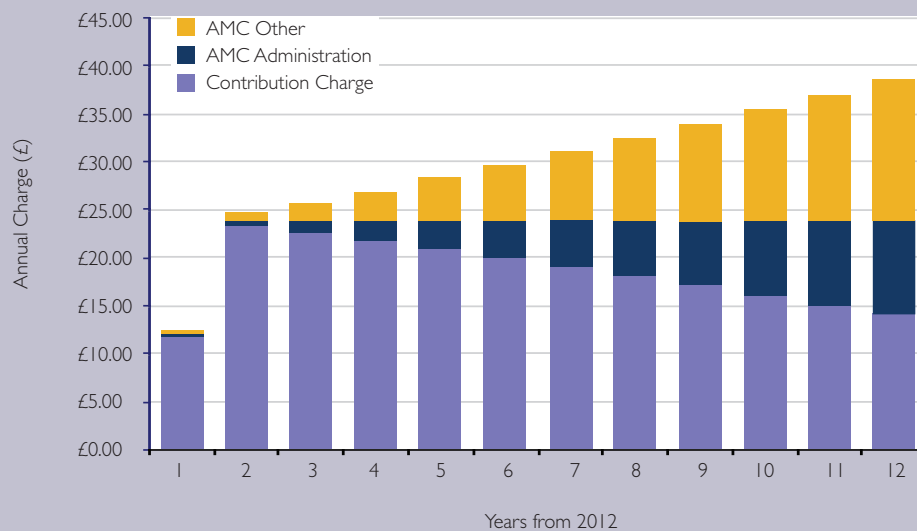
Appendix I: Charging Illustration

The following provides illustrative examples of a contribution charge and an Annual Management Charge (AMC) with an element of capped charge

Example 1: Full Saver

A 25 year old median earner (£15,850) who joins the scheme when it first opens its doors to members and saves consistently on a regular basis:

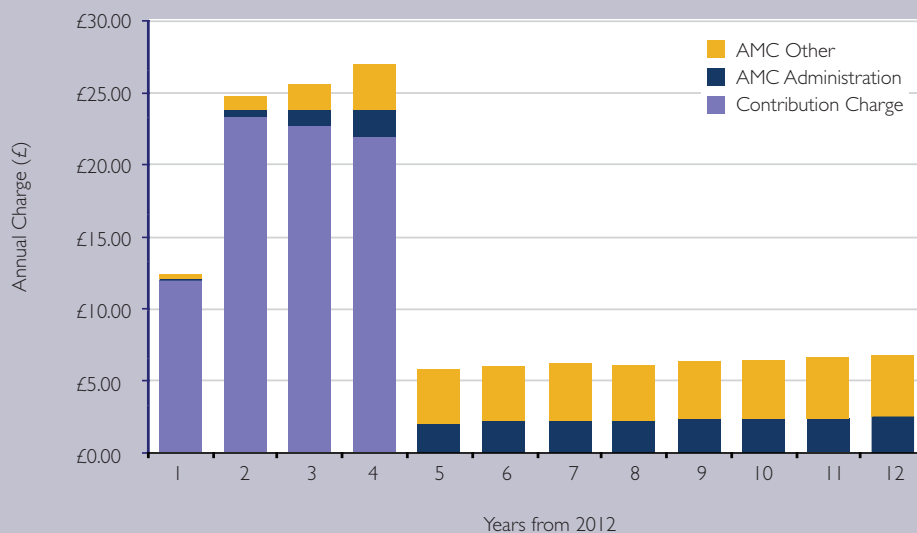
Personal accounts – capped administration charge



Example 2: Short period of saving at 25

A 25 year old median earner (£15,850) who joins the scheme when it first opens its doors to members but saves for 4 years only:

Personal accounts – capped administration charge





Xafinity is one of the UK's leading specialist providers of pensions, employee benefits and payments expertise, with 170 years' experience and handling £2 trillion annually.

The group provides consulting, software, training and business process outsourcing services that enable public and private sector organisations to deliver employee benefits more efficiently.

We were voted both the Flexible Benefits Advisor of the Year 2006 and the Best Pensions Software provider in 2007, and are the accredited software supplier to the UK Principal Civil Service Pension Scheme.

With 1,500 people nationwide, we have operational and relationship management centres across the UK, in Bath, Cardiff, Crawley, Fleetwood, Leeds, London, Reading, Reading (Kings Road), Stafford, Stirling and Waterlooville.

Xafinity paymaster

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