

Response to the Personal Accounts Delivery Authority Consultation

Building personal accounts: choosing a charging structure

24 April 2008

Key Points and Recommendations

AEGON warmly welcomes PADA's consultation on the charging structure for personal accounts. We agree that there are a number of different criteria against which any charging structure should be judged. In our view, the guiding principle should be to match the source and incidence of costs as closely as possible to charges deducted.

While it is important that the charging structure is acceptable to consumers, we must avoid overstating the significance any structure will have on member participation.

Considerations around the structure can't be fully separated from consideration of the level of charges. In particular, it is extremely dangerous to place too much significance on numerical comparisons of retirement outcomes if the parameter values assigned to the different options have not been demonstrated as financially neutral.

AEGON strongly advocates a structure that combines a modest percentage of contribution charge with an annual fund management charge.

We agree with all of the criteria suggested, against which charging structures should be assessed. We suggest some further criteria including focussing on providing value to the target audience and on making sure all business risks are considered.

Assigning weights to the criteria is not a valid approach to comparing structures. Fairness of outcomes between members can be delivered to varying degrees. Participation may be higher or lower depending on a whole range of factors. But sustainability is not something which can be achieved 'by degree'. It is an absolute requirement and any suggestion that the scheme is not 'secure' would have a bigger impact on participation than any differentiation in charging structures.

When considering sustainability, PADA must also consider the parameters and principles set out in law. Firstly, personal accounts are to be available to all – including those who may contribute for only limited periods and / or at low levels. They are also being introduced to complement, and not compete with, good quality existing provision. These twin requirements make it particularly important – in the interests of sustainability – that PADA makes prudent assumptions about all aspects of scheme experience when setting the structure (and in due course the level) of charges.

We do not agree with PADA's chosen definition of fairness. Rather than aiming to deduct the same proportion from members' retirement pots, we believe it would be fairer to broadly match charges deducted to costs incurred by different groups of members on a broad-brush basis.

PADA raises concerns that a minority of individuals might incur excessive costs (for example through frequent requests for information) unless there are financial disincentives to discourage this. AEGON firmly believes policy should be based around

encouraging members to be more, rather than less, engaged with their pension planning. For this reason, we oppose such financial disincentives.

PADA should be open about all of the assumptions which are underpinning the deliberations on charging structures.

We urge PADA to carry out extensive stress, scenario and sensitivity testing against a full range of business risks and to make this analysis public.

Introductory Remarks

AEGON UK welcomes PADA's consultation on charging structures and the open way it is engaging with all stakeholders through this consultation and through meetings and seminars. The selection of the 'right' charging structure is of huge significance, not just to the development and ongoing success of personal accounts, but also to the rest of the pensions (and savings) landscape, as together with the level(s) of charge, it will inevitably become a comparator for other product charging structures.

We fully agree that there is no charging structure that ideally meets all of the criteria against which the personal accounts charging structure should be assessed. We also agree that some of the criteria are of more significance than others. When considering the three categories of criteria, it is important to note that (fairness of) **retirement outcomes for members** and **participation** can be met to varying degrees – they are not 'all or nothing' criteria. None of the options under consideration deliver 100% 'fairness' and participation will be higher or lower depending on a whole range of considerations. However, **sustainability** is much more black and white. While sustainability without access to public subsidy can never be fully guaranteed, we do not believe it is acceptable to proceed if there is even a very modest risk to sustainability. Given the huge uncertainty over aspects such as investment performance, take-up and persistency, this requires some charges to be collected upfront or from contributions. A pure annual management charge structure fails the sustainability test.

We know that some consumer advocates are in favour of a single annual management charge. We also note the findings of PADA's consumer research, indicating consumers prefer a single charge structure to a dual charge structure. But this preference was given without exploring trade-offs in more detail. Were consumers asked to choose between an annual management charge, but with a risk that the scheme might not be securely financed, or a dual charging structure with much greater financial security, we strongly believe they would opt for the latter. Research we have undertaken indicates much greater acceptance of dual charges. We found that unprompted, consumers suggested dual charging structures.

In view of the above, we strongly believe that choosing a charging structure by applying a simplistic form of weighted average across the criteria would be very dangerous. Instead, the differing natures of the criteria need to be reflected and an alternative 'route map' to reaching a decision followed. This should start with a structure which delivers sustainability, and then seeks to optimise against the other criteria.

The concept of fairness is far from simple. Much of our industry has devoted considerable thought to this issue while responding to the FSA's Treating Customers Fairly principle. Rather than aiming to deduct the same proportion from members' retirement pots, we believe it would be fairer to broadly match charges deducted to costs incurred by different groups of members. We stress this can only be practical on a broad-brush basis, and indeed the social policy nature of personal accounts further supports a degree of pooling and cross-subsidy.

The consultation paper ably demonstrates that decisions around charging structures are far from straightforward. If anything, we believe the paper understates the complexity. We believe the personal accounts scheme would benefit from the financial management techniques developed within life offices and other long-term financial institutions. In particular, we strongly urge PADA to fully explore using extensive stress, scenario and sensitivity testing to assess the impact of actual experience differing from assumptions made at outset. Such testing will also allow a better understanding of how scheme charges might move over time – either downwards to reflect a gradual reduction in costs - or upwards to reflect short or long term adverse departures of experience from assumptions.

We also urge PADA to publish both its assumptions and its testing. There is a wealth of expertise in this area within the industry that PADA could benefit from.

Throughout our response, we have suggested PADA undertakes further numerical analysis and modelling. We would be very happy to discuss how best to take this forward.

If there is any aspect you would like to discuss with us further, we would be very happy to help.

The Questions

We have responded to each question in turn. In addition, we make further comments on certain chapters.

In relation to charging and the authority's principles:

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 principles which we believe relate to the charging structure are:

- **encouraging participation in qualifying schemes**

Clearly, the charging structure should not discourage members from joining. We would, however, pick up on a point made relating to the consumer research which is that charges are not a particularly significant element in the joining decision. In our experience, if a customer is asked 'how much does your pension cost?' they are likely to answer in terms of the monthly contribution – not the charge that is deducted.

- **minimising adverse impacts on qualifying schemes and their current and prospective members**

The key issue in this regard is the potential for personal accounts to create an unfair advantage, or the perception of such, over other forms of pension scheme. This might happen if charges are initially set at an unsustainable level or if there are unjustifiable cross-subsidies from general taxation or elsewhere. Some charging structures are more commercially viable than others and to introduce one which is clearly not commercially viable or sustainable would also create an unfair advantage for personal accounts and in doing so discourage membership of other forms of qualifying pension scheme. The consideration around the impact on other forms of qualifying pension scheme should be added to the evaluation criteria.

- **minimising the cost of membership**

We believe this principle is incorrectly articulated. The first step should be to agree on the services and benefits required and the quality of these. PADA should then identify the minimum cost solution to delivering these. This principle will be very relevant when the level, as opposed to shape, of charges is set. However, in terms of charging structures, those that require significant upfront borrowing will incur greater costs in terms of servicing that debt, which ultimately increase the costs of membership.

- **taking into account investment preferences**

The greater the investment choice, the more likely it is that costs will rise. Specialist funds that may appeal to a minority of investors may also increase overall costs. We believe it would be reasonable to pass on extra costs through extra charges to those customers who choose funds that cost more to provide / manage. However, in the interests of simplicity, PADA should avoid offering too wide a choice. The costs of introducing and managing differential charging need to be considered too.

- **respecting diversity**

In the context of charging structures, we interpret this as considering the impact of different structures for individuals with different earnings levels, career patterns and of different ages. The consideration of a number of specimen individuals included within the paper is a helpful means of respecting diversity – although there is a case for extending this to a wider range.

Figure 3.2 in the consultation paper illustrates how all other factors being equal, a higher number of members generates a lower scheme charge. We agree this is true, but only up to a point. Research undertaken for the Association of British Insurers by Oxera ('How to evaluate alternative proposals for personal accounts', October 2006) shows that while there are significant economies of scale up to a fund size of £500m, these become less significant beyond £500m, and in particular once funds under management reach around £1bn. Above this level, the required charge levels out. PADA may wish to consider this further – it has a significant impact on the risks associated with participation levels.

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?

and

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

We concentrate here on packaged investment products and consider charges that are deducted from such products. There are other models that are more 'self administered' and where charges can be deducted to reflect transactional costs. There are also products where it is usual for an adviser to levy a fee that is not collected from product charges.

There are FSA proposals to introduce a new form of adviser remuneration referred to as Customer Agreed Remuneration, defined as 'derived in discussion with the customer and not influenced by the product provider'. This is likely to lead to advisers instructing providers to deduct a certain amount of charge from the policy to pay for advice costs. It is not yet clear if the timing of the deductions from products will match the timing of payments to advisers. But

whatever the outcome, we expect to see a range of new charging structures emerging. We have not included any speculation on this in our points below.

The key types of charge commonly used include :

- annual or fund management charges – deducted as a percentage of fund value. These can vary by fund chosen. They can also vary over time – for example, reducing after the policy has been in force for say 10 years or once the fund value has reached a certain level.
- policy fees, which are monetary deductions usually increased in line with an index
- contribution charges – either a fixed percentage of each contribution or on a sliding scale depending on the level of contribution. There can be a limit on the number of years over which these are deducted.
- bid / offer spreads for collective investment vehicles (these are similar to contribution charges but are generally viewed as less transparent)
- switching charges – usually only deducted if switches exceed a certain number in a given time-period
- active member discounts – these are increasingly common within pensions and reduce the annual management charge while individuals are contributing. The logic of this is to reduce the subsidy which otherwise exists from active members to those with paid up policies (no longer contributing).

Some structures include a mixture of the above.

The core elements of a 'product' are some or all of:

- investment
- insurance / guarantees
- information / communication
- customer service
- advice or adviser remuneration.

The initial costs of some elements can be very different from the ongoing costs. Some elements can be optional, or the product may allow the customer to select from a range (for example fund choice) or to decide on the 'level' of service required (most commonly advice). The charging structure and the level of charges within this are set to cover the costs of all of these elements in a way which treats groups of customers fairly and which is financially prudent for the provider.

The challenges providers have faced in arriving at charging structures are, therefore, very similar to those PADA is now facing – i.e. getting the right balance between good / fair outcomes for consumers, attractiveness to customers (and the advisers who operate on their behalf) and sound financial management at provider level. Providers also have a duty to their shareholders to deliver the required return on shareholder capital (or, in a mutual context, to achieve an appropriate return on existing policyholder assets).

Existing providers operate in a competitive marketplace. When considering attractiveness of their products and charging structures, they need to consider

what else is available within the marketplace. This often creates pressure to offer more competitive terms to remain attractive to customers. The competition dynamics PADA will face will be different.

Clearly, the advice / adviser remuneration element is not relevant to personal accounts. This is an important distinction to bear in mind if, and when, comparisons are drawn between the charges within personal accounts and other forms of pension.

Within personal accounts, there is also no requirement to deliver a profit, although contractors will quite rightly be seeking to profit from their involvement.

The introduction of stakeholder pensions created a major market distortion for pensions charging structures. While the move away from high upfront charges predated stakeholder, the introduction of a price capped product with a flat annual management charge, and a regulatory insistence that any adviser recommending an alternative pension product demonstrated why it was 'at least as good as stakeholder' forced all pensions providers to move their charging shapes and levels into line with stakeholder.

While the introduction of stakeholder pensions did lead to better value products for those customers who bought them, it also eroded the capital base of providers and significantly shrunk the availability of pensions advice. In recent years, we have seen providers significantly cut, or in some cases remove, the commission they are prepared to pay on stakeholder pensions. We have also seen an increasing trend towards reintroducing an element of front-end or contribution charge to pension products, mainly (but not entirely) to facilitate paying for advice. In the current environment, very few people buy a pension without advice, so the value of being able to finance advice should not be underestimated. The introduction of widespread automatic enrolment will change this dynamic, although it would be very wrong and dangerous to assume that concerns over paying for advice will be removed entirely – many individuals will continue to require advice and will need a means of paying for this.

In relation to the charging structure options:

Business risks and sensitivity testing

We fully agree that combination charges are by far the best way to manage business risks. We believe there are additional business risks which need considered. As well as identifying the types, sources and uncertainty of each risk, it is important to understand how they relate to one another. Business risks themselves cannot usually be eliminated without excessive cost. But they can be managed and it is essential that PADA fully explores how it will deal with an adverse event (for example, one that will impact on the incidence and/or magnitude of costs) which in turn will lead to consideration of the prudent amount of capital it should hold or ensure it has access to.

We believe the business risks personal accounts will be exposed to are as

follows:

Risk of expense over-run

This high-level risk arises from any of the following:

- lower than expected average contribution size
- lower than expected initial participation
- lower than expected investment growth
- underestimation of set-up costs
- emergence of an unanticipated cost
- underestimation of initial, ongoing and / or termination/ decumulation expenses
- poorer than expected persistency

Systems, controls and operational risks

With all enterprises of this nature, there are people, systems and procedures that can and will go wrong from time to time.

Risks due to fraud and/or mismanagement need to be fully explored and procedures and safeguards put in place. This costs money.

Lack of diversification

Personal accounts are the only product being offered by PADA. There is therefore a considerable concentration of risk. Providers offering a range of products can diversify their risks (for example offsetting mortality risks within annuities against life cover). PADA will not have that luxury.

Stress and scenario testing

This is fundamental. Projects of this magnitude stand to fail if rigorous modelling and analysis is not carried out before decisions are taken on charge structure and level. The process involves running a model against a number of specific scenarios to ensure that the scheme is able to deal with a wide range of plausible adverse events.

Sensitivity analysis

Results of this will show the degree to which different outcomes will change as a result of incremental changes to the assumptions and the operating environment.

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

We have not identified any strong alternatives.

We agree any joining fee option should be discounted as unacceptable to customers.

We are pleased to see PADA is not considering levying any £ based policy charge or fee on members. For a universal scheme targeted at low to moderate earners, this sort of structure would be particularly inappropriate as it would be disproportionately expensive to those making low contributions who can least afford to pay.

There are charging structures within the pensions (and savings) market which seek to reward those individuals who build up substantial funds. These can take the form of rebates (typically through reduction in annual management charge) to individual members once their fund reaches a particular size, and reduce cross-subsidies which would otherwise exist. Again, the universal nature of personal accounts may make variations at individual member level unattractive.

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

We believe it is valid to consider charging extra for options that are available to members, which will incur additional costs to the scheme, but which are likely to be selected by only a small minority of members. The most obvious example is specialist fund choices. Any extra charge should be closely linked to the expectation of additional costs incurred.

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

We believe it would be reasonable to levy extra charges on members who select funds which incur extra costs. Actively managed funds cost more to manage than passive funds. Sharia funds are also more expensive to operate.

We note PADA's concerns that some individuals may incur excessive costs (for example through frequent requests for information) unless there are financial disincentives in place which discourage certain behaviours. We believe it is much more important to encourage individuals to take an active interest in their pension than to build policy around discouraging excessive engagement – something which current experience tells us is extremely rare. For this reason, we do not support additional 'transactional' charges for requests such as additional statements. For a universal scheme such as personal accounts, it would also be unfair to charge members differing amounts depending on their method of engagement. While internet viewing may be less expensive than issuing paper statements, it would be wrong to require all members to use any one approach for obtaining information.

Once PADA begins to explore the options available when individuals choose to draw benefits from their personal account, it may be appropriate to introduce charges.

In relation to our evaluation criteria:

7. Are these evaluation criteria appropriate?

We very much welcome PADA's consideration of a wide range of evaluation criteria. This mirrors the process life offices go through in deciding on charging structures.

However, we have concerns over the way in which 'fairness' is defined. We do not accept that the most appropriate definition is 'making the proportion of fund values lost to charges constant across members'. We believe further consideration should be given to more closely matching charges to costs incurred by groups of individuals. To illustrate this, let's consider two individuals:

- (a) the individual who makes a single contribution of £30 at age 20 and remains in the scheme until age 65
- (b) the individual who joins at age 64, pays in £3600 and retires at age 65.

These individuals will incur costs for the scheme which are very different. Individual (a) will receive yearly statements for 45 years and will benefit from fund management expertise over this period. The costs incurred by the scheme as a result of their membership will be vastly higher as a percentage of ultimate fund than those resulting from member (b). This is not allowed for if 'fairness' is charging the same proportion of their ultimate retirement pot.

AEGON believes it is fairer to seek to align charges deducted with costs incurred. However, this should only be attempted on a broad-brush basis. The social policy nature of personal accounts strengthens the arguments for reflecting the pooling concept of insurance. In particular, we believe some cross-subsidy from those paying large contributions to those with more modest investments is justifiable in a universally available scheme aimed at providing good value to low and modest earners.

We would be happy to share our more extensive thinking on how different structures can benefit different groups, and fairness between these groups. This underpins our approach to treating customers where we have the ability to design products (or variants of products) and their charging structures to meet the needs of particular groups.

One recent development aimed at addressing a particular point of 'fairness' is the increasing popularity of 'active member discounts'. Most of the costs relating to the running of a group pension scheme are incurred at set-up. Providers seek to recoup these costs over a lifetime of the policy. Through a flat annual management charge, providers will recoup less (and often insufficient) charges from those members who stop contributing after a short period, compared to those who carry on contributing until retirement. Based on our philosophy that it is fairer to broadly match charges deducted to costs incurred, we offer the option of setting up the group pension scheme incorporating active member discounts, where those who are actively contributing to their pension receive a discount on their annual management charge. This charging shape helps to reduce the cross subsidy between those active and 'paid-up' members of pension schemes, all of whom incur these initial costs.

We are not suggesting this approach would be appropriate for personal accounts because unlike in other forms of pension, the individual who stops contributing will not, at least initially, have the ability to transfer their pot to an alternative vehicle.

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

It is very difficult to 'rank' the three high level criteria, particularly because they are all very interdependent. In our response to question 9, we give our suggested rankings for the sub-criteria. However, we strongly oppose any form of weighted average of criteria as an appropriate way of reaching the optimum decision on the charging structure to use. There are other approaches which lend themselves better to this form of decision making.

Different commentators will have differing views on whether sustainability should be considered the most important of the three criteria. But if we put that debate to one side, we do believe most commentators would agree that there are few viable solutions which deliver to this criterion. In fact, we are not aware of any commentator coming up with firm proposals to meet the sustainability test that do not involve some form of upfront or contribution charge. It is very clear that the annual management charge option fails this test. Entering into several billions of pounds of borrowing over perhaps 20 years is not commercially attractive when there are so many variables that will impact on experience and – in consequence – ability to repay.

AEGON agrees with PADA that a joining fee will be significantly off-putting to prospective members. This, in our view, leaves a choice of contribution charge alone or contribution charge plus annual management charge. We strongly favour the latter as a better balance.

Our recommendation to PADA would be to explore how best a structure consisting of a contribution charge and annual management charge, having met the sustainability criterion, can deliver to the other criteria. As part of this process, it would be very helpful to test consumer attitudes in more detail. In particular, it is important to review consumer attitudes to a single or dual charging structure against a background of the financial security of the scheme. We strongly believe financial stability is highly valued by consumers and that they would prefer a dual charge over a single charge if it delivered enhanced financial security.

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

Yes, we believe some additional criteria should be added. The table below summarises what we believe should be the full list of criteria and also ranks these as of High, Medium or Low priority.

	AEGON's suggested weighting (H, M, L)
Retirement outcomes for members	
Distribution of outcomes within generations	H
Distribution of outcomes between generations	M
Participation	
Member perceptions	M
Minimise need for frequent change to offer member perceptions	M
Sustainability	
A viable funding solution	H
Minimise scheme costs – costs of collection	L
Minimise business risks – lots of non contributors	H
Minimise business risks – poor fund performance	L
Minimise business risks – responding to differences between assumed and actual experience	H
Other	
Value for the target market (i.e. those without access to alternative, good provision)	H
Match to incidence of costs	H
Ease of fair review over time	H
Likely fit with contractor charging models	H
Impact on the rest of the pensions market	M

As part of the evaluation of risks, PADA should consider which of these risks best lend themselves to being shared with the contractor(s) who will provide services to the scheme. In particular, fund managers typically charge for their services as a percentage of funds under management. Therefore, if the element of cost associated with fund management is paid for by a charge which is also that percentage of fund, potential mismatch between costs incurred and charges collected for fund management is removed. This approach also makes it easier to explain what charges are for to customers. We believe most customers will be able to understand a statement along the lines of "We deduct a small percentage from your fund over each year (0.3%) to pay for investment management costs. We also deduct a small amount (5%) from each contribution we receive to cover all other costs, including collecting contributions, issuing communications and answering queries."

In relation to member outcomes:

The choice of charging structure will have an impact on retirement outcomes for members. But there are many other factors which have a much more significant impact. AEGON has carried out analysis of the relative importance of various factors. Our findings are summarised in the table below. This looks at the impacts various events or decisions have on an individual offered the chance to join a pension scheme at age 35 and retire at 65, where both the employer and member makes a contribution of 4% of salary:-

Issue	Percentage impact on private retirement income
Member opts out	-100%
Member delays joining for 6 months	-2%
Member delays joining for 3 years	-14%
Member increases their contributions by 10%	+5%
Member loses confidence because of poor investment understanding and leaves after five years	-77%
Failure to take the OMO option	-15% ⁽¹⁾
Overly cautious investment approach	-27% ⁽²⁾
Insufficient protection as members get closer to retirement	-25% ⁽³⁾
Higher charges	-4% ⁽⁴⁾

- (1) This varies and can be as high as 40%. A 15% difference is reasonably common
- (2) An example of a 5% rather than a 7% return
- (3) Again difficult to quantify. A 25% fall in asset values is not inconceivable
- (4) Assuming an additional 0.25% annual management charge

The single biggest impact is from the member opting out. Thereafter, the biggest impact is investment related.

We note the desire to produce fair outcomes not only within, but between generations. Fairness between generations is most easily achieved if charges are collected when, and in the shape in which, costs are incurred. This in turn allows any departure in actual from assumed costs to be reflected fairly by adjusting the appropriate charge.

We support the use of specimen individuals as a means of testing fair outcomes within and between generations. However, it is important to ensure the range of specimen individuals mirrors the anticipated membership. There is a case for extending the range of specimen individuals used and depending on the use to which this is put, it may also be necessary to apply weights to reflect the proportions of the total each specimen member represents.

When looking at intergenerational fairness, it is important to consider the changing profile of both the membership as a whole and of new joiners to the scheme. At outset, the age profile of joiners will be wide, reflecting the profile of those who are not members of, and who do not have access to, a good

workplace scheme. In saying that, we do not anticipate significant take-up amongst those closer to retirement age as this group is likely to suffer most from the loss of means tested benefits. For this reason, we place less importance on the specimen individual who is approaching retirement age.

As we move forward from scheme commencement, new joiners will consist of those who lose access to a good workplace pension (either through moving to an employer who does not offer an alternative to personal accounts or because the employer discontinues an existing scheme) or who join the workforce for the first time. A significant proportion of the latter group will be age 22. Therefore, over time, it becomes increasingly important to strive for fair outcomes for younger joiners. This in turn means any weighting on this group should gradually increase.

We recommend that further analysis and modelling is carried out to consider how charging levels within each shape might change over time under a range of scheme experience against assumptions. This would provide further insight into retirement outcomes both within and between generations (for example, figure 4.6 in the consultation paper). We also recommend this be made public.

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

We suggest PADA considers a wider range of specimen individuals and confirms those used are the most relevant. As stated earlier, depending on the use made of any analysis, it may be appropriate to apply weights.

We are not convinced by the general statements made in paragraph 18 regarding which structure is 'best' for different types of member. Even if these statements are correct, we contend it is more appropriate for PADA to consider what is fairest across groups rather than what is 'best' for any particular group. Our response to question 7 is relevant here.

We note in 4.6 that numerical parameters have been incorporated into the four options. Unless the parameters can be shown to be financially neutral across the options, there is a real risk of inherent skew. The Pensions Policy Institute attempted to create different charging structures with parameter values that were broadly similar in terms of the overall amount of revenue they would generate. We note that PADA has chosen some different parameter values without any explanation.

We would urge extreme caution over using the resulting numbers in detailed decision-making.

In relation to participation in the personal accounts scheme:

We welcome the consumer research PADA has carried out to inform this consultation. Ideally we would like to see more extensive research – a sample of 76 consumers is relatively small considering the huge membership personal

accounts is likely to attract. As with all research, it is important to place the findings in context. We have a number of observations.

If consumers are asked to choose between one charge or two, we would fully expect them to select the former. We agree it is simpler. But in practice, consumers will pay very little attention to the precise nature or structure of charges – as long as they have an overall comfort that they are receiving good value and their investments are safe. We would fully expect consumers to view personal accounts as good value.

AEGON has recently undertaken research with consumers regarding their preferences for receiving and paying for different forms of advisory service. We have found it instructive to present financial services in language more reminiscent of other retail purchases. In terms of willingness to pay, we have asked consumers to consider what looks reasonable when compared to other services they already purchase – for example, gym memberships, boiler maintenance contracts and private health care.

In regard to the preference for a single rather than dual charging structure, consumers deal with much more complex charging structures in many other fields such as utility billing, (mobile) phone packages and cable TV subscriptions.

We strongly believe a simple message along the lines of

“We deduct a small percentage from your fund over each year (0.3%) to pay for investment management costs. We also deduct a small amount (5%) from each contribution we receive to cover all other costs, including collecting contributions, issuing communications and answering queries.”

is simple and clear and meets the need to demonstrate fairness.

In conclusion, we would place only limited weight on consumer preference for a single charge, especially when compared to the huge benefits dual charging provide both to truly fair outcomes and, importantly, to all aspects of sustainability. Were consumers asked to choose between an annual management charge, but with a risk that the scheme might not be securely financed, or a dual charging structure with much greater financial security, we strongly believe they would opt for the latter.

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

In our experience, the effects of different charging structures are modest. Consumers spend little time thinking about financial services products, let alone their charging structures. Product disclosure material that attempts to explain the level and shape of charges and their impact on the customer's outcome are notoriously difficult to make consumer-friendly. There are real risks of excessive

disclosure and of poor presentation making changes look disproportionately high. Disclosure should place at least as much importance on highlighting the benefits of saving, not just the costs!

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

We agree with PADA's findings that charges are not likely to be a significant barrier to consumers joining as long as there are no 'causes for concern'. Perception of charges is very low on the list of factors influencing participation. The key factor is, inevitably, affordability. Another factor, of increasing importance, is security. Individuals want to know their money is safe. For this reason, we place considerable importance on those criteria relating to sustainability, and believe they have a strong link to member perception. Recent research from Brewin Dolphin ('Pensions at risk from debt repayment', March 2008) painted a worrying picture of individuals already in pension schemes deciding to suspend contributions when other factors such as those we are experiencing today make finances tight.

In relation to minimising scheme costs:

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

Of all the criteria, we believe this one is of lowest priority. A modern policy administration system would easily cope with any of the options under discussion for personal accounts with no noticeable difference in the charges which would have to be levied on members. And as discussed earlier, we do not believe policy decisions should be made around discouraging over-interest from members in their pension!

ABOUT AEGON

AEGON has assets under administration of £53.2 billion and employs around 4,900 staff. AEGON is part of the AEGON Group, which is one of the world's largest listed insurers and has assets around Euro 371bn (£272 billion).

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