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Legal Update
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Charges cap in money purchase default arrangements: mapping and white-labelling

The final version of the charges cap regulations were published last week and are due to come into force on 6 April. Broadly, they will impose a 0.75% cap on charges in money purchase default arrangements. But the regulations give an unexpectedly wide meaning to "default arrangement" in this context, and they will in fact apply to investment options that one wouldn't normally think of as default funds. Trustees of all schemes where money purchase contributions are still being accepted should consider whether they need to take urgent steps in order to comply.

The charges cap only applies to "qualifying schemes", i.e. schemes where money purchase contributions are still being accepted, where the employer's staging date for automatic enrolment has arrived, and the employer is using the scheme to meet its automatic enrolment duties in relation to the scheme's active members.

Additionally, the charges cap is not intended to apply to AVC funds in DB schemes unless the same funds are also made available to members of a money purchase qualifying scheme used by the same employer for automatic enrolment purposes.

The charges cap and its implications

If contributions are paid after 6 April 2015[1] to an investment option which counts as a "default arrangement", the charges cap applies to all money invested in it (past and future). This means that the charging structure must be either a single charge structure (where charges are calculated solely by reference to the value of the member's rights and do not exceed 0.75% a year), or a combination charge structure (based partly on the value of the member's rights and partly on either a flat fee or a percentage charge on new contributions; the regulations contain detailed rules setting out how the cap applies to combination charge structures).

1 Or the employer's automatic enrolment staging date if later.

If a fund is a "default arrangement" in relation to an employer and accepts contributions on or after 6 April 2015, or the employer's later staging date, the regulations will treat it as a default fund in relation to that employer forever, even if members stop contributing to it or if it stops being used on a default basis.

"Default arrangements"

The crucial points here are that a "default arrangement" includes things that one wouldn't normally think of as a default fund, and that the charges cap will apply to all types of default arrangement.

The definition does include default funds in the traditional sense, i.e. a fund or funds into which new joiners' contributions are paid automatically unless the member expressly chooses a different fund.

But the charges cap will also apply:

- (if there is no default fund in that traditional sense) to any investment option which is accepting new contributions in respect of 80% or more of the active members on 6 April 2015 (or the staging date if later), even if those members *have* made a specific choice to invest in it,[2] and
- to any other fund which accepts new contributions in respect of active members on or after 6 April 2015 (or the later staging date), without all those members having expressed an active choice to contribute to it.

2 There is an exception if all members contributing to the arrangement on 6 April (or the later staging date) had previously specifically agreed, in writing and before that date, that they wished future contributions after that date to carry on going into that fund (rather than being diverted to a different default fund from that date), and they have expressly acknowledged that the charges there might be higher than the regulations would otherwise allow.

The mapping and white-labelling problem

The last limb of the definition will catch funds to which contributions are paid following a "mapping" exercise. Mapping occurs when trustees change the fund range available in their scheme, and members who contributed to funds that are being withdrawn are automatically transferred ("mapped") into a similar replacement fund unless they actively choose an alternative fund.

Members who did not actively choose an alternative fund under a mapping exercise have not expressed an active investment choice: they moved into the replacement fund by default. If contributions are still being paid to the replacement fund on or after 6 April 2015 (or the later staging date), and the members concerned have still not expressly chosen that option, then the replacement funds will count as "default arrangements". The charges cap will apply to them, just as it would to a traditional default fund.

The same issue may arise where a scheme offers "white-labelled" investment options, in other words where members choose the generic type of fund they want their contributions to be invested in, but others can decide from time to time which particular fund is used behind that "wrapper". Whether the same issue arises will depend on the way that the investment option is structured.

What should trustees do?

Where the charges cap applies to an arrangement, trustees must either:

1. satisfy themselves that the charges in the arrangement are below the cap (or arrange for them to be reduced below it); or
2. from 6 April 2015 (or the later staging date) divert contributions to an alternative arrangement where the charges are below the cap, except where, before that date, an active member has expressly chosen that contributions should continue to be allocated to the current arrangement.

Where option 1 is not available, trustees should write to the affected members and give them the choice of confirming in writing that they wish to remain in the higher charging arrangement or (if they fail to confirm by an appropriate deadline) having their future contributions moved by default to a lower charging arrangement. However, scheme rules will need to be checked to ensure that they allow this approach.

As the charges cap comes into force on 6 April 2015, trustees have very limited time to run this communications exercise (bearing in mind that a decision will need to be taken first about what the appropriate lower-charging vehicle should be). They should therefore make a decision on the course of action they plan to take as a matter of urgency.

While the regulations do contain some limited easements for trustees who have used their best endeavours to comply with the law, trustees will not be able to rely on them unless they really have taken every step available to them to comply before the 6 April deadline: trustees who don't do their best to comply have not used their "best endeavours". This will be therefore at best only a partial solution.

What if trustees don't take action?

Should the trustees fail to ensure that charges in their default arrangements are below the charges cap from 6 April 2015, the Pensions Regulator has the power to issue compliance notices requiring them to take corrective action and/or to issue penalty notices (i.e. fines). In addition, members in the default arrangement could bring a claim against the trustees for the financial loss caused to them by the trustees' failure to comply with the charges cap.

In addition to the charges cap, the regulations impose a range of governance standards on money purchase schemes. We will be writing separately about these.

The Regulator has published an essential guide for trustees on the new charges cap and governance standards.

If you have any questions on the issues raised in this alert or require further advice, please contact your usual Mayer Brown contact or:

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