



Institute
and Faculty
of Actuaries

Better workplace pensions: further measures for savers

Institute and Faculty of actuaries response to the
Department for Work and Pensions

14 May 2014

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.



Private Pensions Policy and Analysis
Department for Work and Pensions
1st Floor, Caxton House
6-12 Tothill Street
London
SW1H 9NA

15 May 2013

Dear Sir/ Madam

IFoA response to Better workplace pensions: Further measures for savers

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the DWP's consultation *Better workplace pensions: Further measures for savers*. This response has been written by our Defined Contribution Advisory Group, with input from our Defined Benefits Consultation sub-committee for question 11.

The key points we raise are:

- We consider good quality administration to be central to the successful management of a pension arrangement; and we suggest that accreditation is a useful way for organisations to demonstrate their commitment to providing a quality service.
- There is a need to balance a variety of potential approaches to achieving quality with the need to ensure that members receive value for money.
- The definition of 'independence' should be applied consistently and, for mastertrusts, there should be clarity on where independence is required and from whom. The requirement for default strategies to be designed in the interests of members is crucial to ensuring good member outcomes. It is equally important to monitor performance and ensure that the position is reviewed as members' needs and investment opportunities change over time.
- Setting the quality standards in regulations is the best way to ensure compliance in practice.
- It is important that all DC schemes comply with transparency requirements.
- We suggest that, for DB schemes, the current mechanisms for transparency of costs are satisfactory.

1. We would welcome views on the potential benefits of accreditation of administrators and what role government and regulators could play in supporting this.

We consider good quality administration as central to successful management of a pension arrangement and, particularly for DC schemes; good quality requires promptness, accuracy and clarity of information for members.

Accreditation is a useful way for organisations to demonstrate their commitment to providing a quality service. The consultation refers specifically to the Pensions Administration Standards Association (PASA) programme; we suggest organisations may already have a range of different accreditations or regulatory oversight, including FCA / PRA, ISO9001, AAF 01/06, Plain English Awards. We see merit

in the PASA programme being focused specifically on pensions administration, whereas other accreditations are more broad-based. However, we suggest it is important that, at least initially, PASA is not promoted to the exclusion of other accreditations.

We agree that accreditation should be on a voluntary basis at this stage.

2. We would also welcome suggestions of other approaches to helping trustees and Independence Governance Committees (IGCs) ensure that their scheme is being administered to a good standard

Other approaches trustees and IGCs can consider might include sample-testing of processes to assess the quality and timeliness of work. Feedback from members, in relation to their experience, and their views on clarity of information, for example through a member survey, may also provide a useful tool for understanding the quality of a scheme's administration.

The use of performance related fees for the administration provider may help improve standards. Service Level Standards published to the scheme members should help them understand what to expect from the administration provider. A clear complaints and redress process should help ensure issues are successfully addressed when administration problems do arise.

In achieving good quality administration, there should be a recognition that this may conflict with the goal of minimising costs. Trustees and IGCs may usefully ensure there is an appropriate balance between the need for quality and value for money for members.

3. Should mastertrusts have to meet the same independence standards as providers of contract based schemes?

The IFoA supports this proposal. To ensure a level playing field across different structures of DC schemes provision, it is sensible to apply the same independence standards to mastertrusts.

Whilst the legal structures and responsibilities are different, mastertrusts can operate in a very similar way to contract based schemes for day-to-day administration. As a result, the independence of the trust board is important to remove conflicts of interests between member outcomes and commercial considerations of the providers of services to the scheme.

4. We would welcome views on the proposed definition of 'independent' at Annex B.

The requirement that an independent trustee has not had a material business relationship with the company in the last three years is a reasonable approach. However, there may be good reason for that requirement to specifically exclude the provision of independent governance, or advice, to the provider/scheme.

Many DC providers operate books of significant scale. In the long term, it is likely that some mastertrusts will also grow to significant scale. It is, therefore, important that trustees and members of IGCs have relevant skills and experience to perform their duties. Whilst independence is a critical factor, guidance on the skills and competencies required by individuals should also be provided to ensure the highest quality of decision making.

Under mastertrusts, clarity will be required around who takes the role of the "provider" for appointments to the trust board. For some mastertrusts, this may be the "sponsor" of the scheme; whilst for others, it may be passed on to an independent trustee firm.

The independence requirements have been written to ensure independence from the provider. However, independence of IGC members is also required to ensure all members are acting only in

the best interests of the end customer; this might be achieved through a declaration of a conflict of interest.

5. Should the independence requirements be applied in different ways to different models of mastertrust? In particular, how should the independence requirements be applied to mastertrusts that use an independent trustee firm to act as their corporate trustee?

For mastertrusts, there should be clarity on where independence is required and from whom. The independence should not be from the trustee firm, if acting as its corporate trustee but, instead, from those companies providing services to the trust.

For example, the requirements should ensure members of the trust board are independent from product providers, scheme advisors, investment fund managers, administrators and IT/technology suppliers, etc.

Independence should be applied consistently. In the case of an independent trustee firm acting as a corporate trustee, it would seem sensible to be independent from the sponsor (the party who ensures payment of the independent trustee firm's fees).

6. We would welcome views on the proposed quality standards for trust-based governance which are summarised at Annex B

In broad terms, we agree that the quality standards are appropriate, and there is significant overlap with those set out in the Regulator's own guidance, through Code of Practice 13 and the attaching regulatory guidance.

The requirement for default strategies to be designed in the interests of members is crucial to ensuring good member outcomes. It is also critical that default strategies are kept under review over time; performance is monitored and the position reviewed to account for the changing needs of members over time, changing investment opportunities, and in light of future legislative regulatory and environmental developments.

Trustees should assess costs and charges to satisfy themselves that they represent value for money for members, and ensure they are properly disclosed.

We also recommend that there should be requirements for trustees to provide appropriate support for members. This may help to ensure that members recognise how they can influence their outcomes through the choices they have available to them; and assist them in taking those choices in practice. In particular, focus should be put on levels of savings and robust support provided in the lead up to retirement. This area should be subject to further attention in view of the Budget announcements.

7. Are the requirements listed at paragraph 8 the right quality standards to be set in regulations for trust-based schemes?

We refer to our response to question 6 on the suitability of the quality standards. In broad terms, we consider setting the quality standards within regulations is the best way to ensure compliance in practice. Our response to question 9 is also relevant.

8. Should trust-based schemes be required to have a chair of trustees?

We understand that the Chair of trustees should play a pivotal role in ensuring effective scheme governance and, therefore, it would be appropriate that one is formally required. Most schemes already have a Chair in practice.

9. Will the new reporting requirements help drive compliance with the standards and regulation of these? Will the new reporting standards help drive compliance?

We agree they could make a material difference, as standards of governance in DC schemes remain relatively low. DC is still competing against DB for finite governance resources. Setting quality standards in regulations, and requiring compliance reporting, will mean that these issues will require an appropriate degree of attention.

10. We would welcome views on how these transparency requirements could be made to work effectively in unbundled trust-based arrangement (including mastertrusts).

It is important that all DC schemes comply with transparency requirements. One of the challenges for unbundled trust based arrangements will be sourcing the relevant information from their third parties (i.e. fund managers). Ensuring that transparency requirements apply to asset managers of pension funds is key to overcoming this challenge across the DC industry. In our earlier response to *Better workplace pensions: a consultation on charging*, we noted the importance of the disclosure of consistent information for all schemes, whether trust or contract based. Sufficient information should be provided to employers and trustees to enable them to make informed decisions; conversely, members should not be overwhelmed by a volume of information that could result in confusion rather than clarity.

The transparency requirements could helpfully consider the frequency and accuracy level applied. More frequent and more accurate requirements may actually cost more than the subsequent benefit for unbundled trust based arrangements. Requirements for transaction costs and additional expenses to be calculated across a mixed portfolio/blend of funds at set points (e.g. quarterly), or based on target asset allocation, would significantly reduce effort, compared to the need for daily monitoring of small changes in fund mix. This would still create transparency and support trustees in making effective decisions.

11. We would welcome views on whether the transparency requirements we propose for DC schemes should, in the future, be extended to DB schemes, to enable sponsoring employers to further scrutinise the costs of such schemes.

It would be useful to have clarity on how the proposed transparency requirements will apply to a DC element of a hybrid benefit, or within a hybrid scheme, such as Small Self-Administered Schemes.

It could be beneficial to apply similar principles of transparency to DB schemes, ensuring that trustees have the right information to make the best decisions for DB scheme members. Whilst there may not be a direct link between fund management costs and members' benefits, the funding of a DB scheme would be affected by sub-optimal investment decisions from not understanding hidden costs of carrying out transactions.

At a high level, the benefits payable to members of DB schemes do not depend directly on the charges incurred in running a DB scheme. Those charges are, in general, paid mostly by the sponsoring employer. In addition, the financial risk in providing benefits under DB schemes rests with the trustees and sponsoring employer, rather than with individual members. The advice regime available to trustees and sponsoring employers is better developed, and generally at a higher level of expertise, than necessary in the context of minimum standards required for members of DC schemes. It should also be noted that the level of scheme governance is more robust in the more mature DB schemes market than for DC schemes. Thus, the requirement for minimum standards is less of a material issue for DB schemes.

There is a well-developed and mature market for the provision of relevant services to DB schemes. The range of providers is also quite diverse; ranging from insurance companies, which will usually deal with smaller DB schemes; to major firms of consulting actuaries, which tend to advise the larger

DB schemes. The way that charges are expressed can be different. For some DB schemes, they may opt for a “bundled” approach, where a range of services is provided, and the charge is usually expressed as an annual percentage charge of the scheme assets. Alternatively, an “unbundled” solution will tend to split up charges into identifiable fees for particular services. It is also possible to mix bundled and unbundled approaches. In each case, the charge for services provided, whether bundled or unbundled, will be clear to the trustees or sponsoring employer, as appropriate. In carrying out their duty of acting in the best interests of the DB scheme members, the trustees will be keen to ensure the ongoing viability of the DB scheme by seeking to ensure that the sponsoring employer is not subject to higher costs than necessary. To that end, the trustees are likely to carry out regular reviews of charges from their providers. This, together with scrutiny by the sponsoring employer, will act as a control on costs incurred.

We welcome transparency of costs for DC and DB schemes, but we suggest that the current mechanisms are satisfactory for DB schemes. Should you wish to discuss any of the points raised please contact Philip Duggart, IFoA Policy Manager (Philip.Duggart@actuaries.org.uk/ 01312401319) in the first instance.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Nick Salter', written in a cursive style.

Nick Salter

President-elect, Institute and Faculty of Actuaries