Institute
and Faculty
of Actuaries

Better workplace pensions: Putting savers' interests first

Response to the Department of Work and Pensions

19 November 2014

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Institute and Faculty of Actuaries

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IFoA response to Better workplace pensions: Putting savers' interests first

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to DWP's consultation 'Better workplace pensions: Putting savers' interests first'. This response has been drafted by IFoA members who work in pension schemes, both Defined Benefit (DB) and Defined Contribution (DC). We have limited our response to areas where the IFoA can offer specific comment.

Question 1:

(a) Does the definition of "relevant scheme" (regulation 2) meet the policy intention of protecting members of schemes used for automatic enrolment from high and unfair charges?

2. The DWP has highlighted in its Command Paper (Paragraph 14) the challenges of understanding what is meant by "defined contribution". The IFoA has commented previously that there would be merit in providing consistent definitions of "money purchase" and "defined contribution" during this period of extensive change in pensions legislation.[1]

3. Given the current definitions, the IFoA considers that the definition of *relevant schemes* generally meets the policy objective. However, there is a lack of clarity around the treatment of DC Additional Voluntary Contribution (AVC) arrangements that sit within a DB scheme. The proposed arrangements would exclude these from the governance requirements, but the Pensions Regulator's (tPR) Code of Practice for the "Governance and administration of occupational defined contribution trust-based pension schemes" currently has such arrangements in scope.[2] The IFoA would encourage a consistent approach in the scope of regulation in this matter.

(b) Does the definition of "relevant scheme" at (regulation 13) meet the policy intention of ensuring that workplace schemes are well governed in members' interests?

4. The exclusions within the definition of "relevant schemes" in regulation 13 are appropriate given the extent to which the schemes excluded already provide protection for members. However, in relation to the specific question asked, the definition itself does not guarantee good governance in members' interests. Good governance will be provided within an appropriate and proportionate framework and guidance on what constitutes this is contained

[1] http://www.actuaries.org.uk/research-and-resources/documents/ifoa-response-hmrc-draft-legislation-taxation-pensions-bill (paragraph 8)
[2] http://www.thepensionsregulator.gov.uk/docs/code-13.pdf (paragraph 10)

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within the draft regulations. This is a welcome inclusion but, ultimately, the delivery of good governance for scheme members, which should contribute to better outcomes during later life, will depend on those responsible for the governance function carrying out their duties in the best manner possible.

Question 2: Do the draft regulations (regulations 4(3) and 4(4)) meet the policy intention of excluding from the charge cap members of qualifying schemes who have the advantage of a third party promise?

5. Our understanding is that for a scheme with investment options providing a third party promise (e.g. with-profits funds), but where there is no obligation for scheme members to select one of those investment options, the scheme would not be regarded as a relevant scheme. We are unclear if the treatment of such investment options is consistent with the policy intention. The IFoA would welcome any assistance the DWP could offer in this regard, particularly if the Regulations could better reflect the treatment of schemes with this type of investment option. We understand that the DWP expects some with-profits funds to be subject to the cap and others to be excluded depending on the specific policy terms. If so, the IFoA would encourage the DWP to offer examples of how this would work in practice.

Question 5: Does the definition at regulation 1(2) capture those schemes described as master trusts in chapter 2?

6. The IFoA would encourage the DWP to confirm whether all industry-wide schemes would fall within the definition within the Regulation.

Question 6: Do the draft regulations meet our policy intention of ensuring that occupational schemes are well-governed?

7. The draft regulations identify those issues that will have an impact on members' ultimate benefits during retirement. In general, the regulations should enable trustees or managers (hereafter referred to as "trustees") to govern the schemes well in accordance with the policy intent. However, the IFoA would look for further clarification from DWP in relation to two specific areas:
    i. In regulation 18, trustees are required to calculate and assess transaction costs "in so far as they are able to do so". As has been identified in earlier DWP consultations, transaction costs are not always readily identifiable; therefore, it would be helpful to understand the extent to which trustees must attempt to recognise these costs. The policy intent may be achieved if trustees were to request and assess the information from investment managers, who had a clear regulatory responsibility to supply it. The balance of responsibility would, under the draft Regulations, lie with the trustees, but the information lies with the investment managers. Trustees may then be better able to disclose it to members. Trustees also need to be aware of the penalties for failure to address transactions costs with sufficient rigour. DWP guidance would provide trustees with a more exact meaning of the term 'in so far as they are able to do so', particularly in situations where the trustees request the relevant information from investment managers, but it is not forthcoming.
    ii. In regulation 19, trustees are asked to invest "in the best interests" of relevant members. Given the new flexibility within the pensions regulatory environment, the best interests of members may not be entirely clear to trustees. As different members may elect to receive pension benefits in different forms, the definition of best interests may also differ between specific groups of members.

8. As we suggested in our response to the FCA consultation about Independent Governance Committees (IGCs), the IFoA would strongly welcome a consistent approach to pension

scheme governance, no matter the legal constitution of schemes.[3] Consequently, we would wish the requirements of IGCs to be consistent with the requirements of trustees in relation to the governance of scheme benefits.

Question 7: Do you have any comments regarding the policy on who should have the duty of compliance with the charges measures?

Do you have any comments about how the draft regulation (regulation 4) meets the policy intention?)

9. The IFoA agrees with the policy intent that trustees for occupational schemes and providers for personal pension schemes should disclose charges**.** However, there should also be an obligation for investment managers to provide the trustees with the appropriate information, in particular, the transaction costs.

10. It is unclear where recurring property costs (for example, annual maintenance costs) would sit within the charge cap. If these costs were included, there could be limitations on including less liquid assets within default arrangements. The IFoA would welcome clarification from DWP in respect of these costs.

11. As we also noted in our response to question 2, we would welcome clarification on the provision of the third party promise and the extent to which a scheme could consider itself to be exempt from the charge cap.

Question 8: Do you have any comments on the policy regarding the member borne deductions that fall within the cap, and how the draft regulations reflect the policy intention? These exclusions are:

(a) the non-recurring variable transaction costs which are incurred by a scheme when buying, selling, lending and borrowing underlying investments ("transaction costs" definition in regulation 2)

12. It is appropriate to exclude these costs; however, trustees may not always be clear as to what costs fall within this definition and how the distinction is made between recurring and non-recurring transaction costs. Investment managers should be able to provide this distinction for trustees; therefore, there should be an obligation for investment managers to inform trustees. If trustees are expected to make best efforts to understand transaction costs, caution may dictate trustees to include all transaction costs without making the distinction indicated by this policy intent.

(b) pension sharing and compliance with court orders ("charges" definition in regulation 2)

13. As pension sharing is beyond the control of the trustees, it is reasonable to exclude such costs from the cap.

(c) winding up costs ("winding up costs" definition in regulation 2)

14. Winding up costs are specific to the circumstances of a scheme and are not incurred in the on-going administration of the scheme. Consequently, it is appropriate to exclude them from any cap.

Question 9: Do you agree with the policy on which the draft regulations are based (see regulation 3) – to capture as many workers as possible who made no active or informed choice

[3] http://www.actuaries.org.uk/research-and-resources/documents/cp1416-proposed-rules-independent-governance-committees

about their investment strategy, whilst also minimising the risk of capping funds where members made an active choice?

15. The policy intent to capture as many employees as possible is appropriate. However, there are two specific points the IFoA wishes DWP to consider:
    i. For multi-employer schemes, the approach to determine funds covered by the cap may result in a large number of funds having to conform to the cap which could have unintended consequences resulting from choices made by employees of any one employer. This may be particularly acute for smaller employers, where active investment choices may result in funds having to adhere to the cap, even if that had not been the original intent of the list of investment options.
    ii. It would also appear to be disproportionate for trustees to consider funds as default funds if the future active investment choices were to mean that 80% of members chose a particular fund. We would encourage more flexibility in such cases.

16. The IFoA would propose an alternative approach for smaller employers and trustees to overcome these challenges. While the regulations appear appropriate for larger employers, there are alternative approaches available if it was difficult to identity the default fund.

17. For smaller employers, it could be possible to make an informed decision and nominate a default fund that would be subject to the cap. Alternatively, the 80% rule could only apply to schemes that are larger than a given size. While recognising the benefit of the policy intent, we would suggest the 80% could apply only to schemes with more than 10 members. One other option could be to apply the 80% rule to the total amount of contributions paid into each fund.

Question 10: Do you agree that the draft regulations (regulation 3(3)) should allow members who have made a recent active choice to remain in an arrangement which is not subject to the charge cap?

Is the 3 month time period allowed reasonable?

18. This approach is proportionate.

Question 11: Do you have any comments on the policy about protecting the members to whom the cap applies?
Do you have any comments about how the draft regulations meet the policy intention?

19. The approach proposed does not impose too heavy a burden on employers, trustees and providers. The obligation on trustees to provide an offer to transfer to charge-compliant funds provides members with the necessary protection.

Question 12: Do you have any comments on the policy intention of:

(a) imposing the cap on the total fund of the member and not just on contributions made after the relevant date?

(b) prohibiting charge structures other than those set out in paragraph 68 (and reflected in regulation 5)?

(c) limiting the opportunities for altering charging structures as described above, whilst avoiding locking schemes into particular charging structures indefinitely? (regulation 5(4))

20. The IFoA welcomes the proposed approach. We strongly support the application of the cap to all funds and not just to contributions after the relevant date. However, it would be more

proportionate to apply this approach for the first complete scheme year after 6 April 2015. Otherwise, schemes may not immediately comply with the cap even though trustees had followed the correct approach. Enabling trustees to change charging structures at year ends is also a proportionate approach that can also be in the interest of scheme members.

Question 13: Do you have any comments on the policy described above in relation to the valuation of the member's fund and the period over which the charge cap applies? And do you have any comments on how the draft regulations reflect that policy (regulation 7)?

21. The regulations allow the significant variance in charging structures to incorporate the charge cap while at the same time offering scheme members sufficient protection.

Question 14: Do you have any comments on the policy regarding opt-in services described above?

Do you have any comments on the draft regulation (regulation 8) which reflects that policy?

22. It is possible that the member could elect to take cash from a policy as part of the flexible retirement opportunities; however, this could be considered as an opt-in service which could mean that a policy would no longer be subject to the cap, even if remaining significantly invested. We would welcome clarity around this point.

Question 15: Do you have any comments on the policy in relation to Active Member Discounts?

Do you have any comments on the draft regulation (regulation 10) which reflects this policy?

23. The draft regulations reflect the policy intent.

Question 16: In addition to the questions already asked, is there anything else in the policies as set out in this paper on which you have any comments? Do you have any comments on how the draft regulations reflect the policies explained in this paper?

24. It is the practice for some schemes to calculate charges in one year, but deduct them in the following year. It is possible that the deduction could exceed the charge cap for the year in which it is deducted, but not exceed the cap for the year of calculation. The IFoA would welcome DWP's clarification that this methodology would be acceptable

Question 17: Is the scheme return the most proportionate way to obtain information on compliance with the governance standards and charges measures? Draft regulation 23 sets this out in more detail.

25. Using the scheme return minimises any additional administration requirements for trustees.

Question 18: Is the proposed compliance approach to the Chair's Statement, as described in draft regulations 24 and 26 appropriate and proportionate?

26. The IFoA would regard this proposed approach as proportionate and appropriate.

Question 19: Do the adjustment regulations (regulation 9(2)(a)) reflect our policy intent of providing an adjustment mechanism for occupational schemes which cannot stay compliant with the charge cap, to take action to resolve the situation promptly?

27. The regulations will require trustees to take immediate action in the best interests of members. This will be a major exercise that will affect a significant number of schemes

placing pressure on resources and possibly incurring initial costs. Whilst the adjustment regulations recognise this effort required, we are unsure whether they provide trustees with the means of complying with the proposed legislation in all circumstances. In particular, our reading of the adjustment regulations is that trustees would be able to delay compliance with the charges cap until a short period after April 2015 should their best efforts to comply by April 2015 prove ineffective. Nonetheless, the trustees would still need to ensure compliance for each individual member when the charges are considered over the complete 2015/16 year. This may be feasible for members who remain in the arrangement throughout the year (for example, if the trustees introduce a reduced charge a few months after April 2015, which is sufficiently below the 0.75% cap to counter any excess charges that members have paid over the first few months of the year). However, such an approach would not work for any member who transferred benefits out of the arrangement or retired during those first few months. The consultation document implies that the trustees would have to recompense such members for the excess charges they have paid. In a pure money purchase arrangement the only possible source of compensation would appear to be the sponsoring employer, but the employer would be under no statutory obligation to provide these additional funds. We would welcome the opportunity to work with DWP and other interested stakeholders on potential solutions.

Question 20: Do the adjustment regulations (regulation 9(2)(b)) meet the policy intention of providing an adjustment mechanism for occupational schemes when, as a result of an unexpected event, they are unlikely to be able to comply with the cap?

28. The IFoA regards the regulations as meeting the policy intent.

29. If you wish to discuss any of the points raised please contact Philip Doggart, Policy Manager (philip.doggart@actuaries.org.uk/ 01312401319) in the first instance.

Yours sincerely

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