

**Offering a default option for
defined contribution automatic
enrolment pension schemes: a
response by the NAPF**

March 2011

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Offering a default option for defined contribution automatic enrolment pension schemes

Executive Summary

- The NAPF believes the approach to guidance regarding default fund design set out within “*Offering a default option for defined contribution automatic enrolment pension schemes*” to be overly prescriptive.
- Moreover the guidance could potentially be a duplication of existing FSA guidance and would appear to go against the commitment within the Coalition Agreement not to impose unnecessary or additional burdens on pension scheme sponsors.
- The guidance should not be extended to trust based DC schemes because trustees already have specific fiduciary responsibilities under law and access to specialised professional advice to assist them in default investment fund design.

Recommendation

- The NAPF believes a principles based approach to guidance, not further regulation, is the best way to improve standards in relation to DC default design and encourage better member outcomes for DC scheme members. If guidance is to be adopted then it should not be extended to trust based DC schemes given the specific fiduciary responsibilities of trustees.

1. Introduction

1. The NAPF supports the 2012 reforms. The introduction of auto-enrolment and mandatory employer contributions will mean that 5-9m people will start saving or save more into a pension. This, alongside the creation of the new National Employment Savings Trust (NEST) will extend workplace pension provision to those who currently do not have access to it.
2. The NAPF welcomes the opportunity to respond to the DWP consultation document "*Offering a default pension in defined contribution auto enrolment pension scheme*". In December 2009 the NAPF submitted a response to "*The use of Default Options in Workplace Personal Pensions and the use of Group Self Invested Personal Pensions for Automatic Enrolment*". In this submission, the NAPF proposed that guidance remain generic and cautioned against an overly prescriptive regulatory approach to the issue of default investment funds.

About The NAPF

3. The NAPF is the leading voice of workplace pensions provision in the UK. It speaks for 1,200 pension schemes with some 15 million members and assets of some £800 billion. Its membership also covers around four million people with public sector pensions.

2. Specific Issues of Concern

4. The NAPF recognises the importance of the default investment fund within all DC arrangements and welcomes the DWP public consultation as adding to the wider debate regarding default investment fund design, review and governance. However, we have a number of concerns with the approach proposed by the DWP.
5. Our specific areas of concern are as follows:
 - **Unsuitability** - The NAPF retains the overall view that this guidance as drafted by DWP is too uniform and prescriptive for contract based Workplace Personal Pensions (WPPs) and is completely unnecessary in terms of trust based DC plans.
 - **Good governance remains key** - The NAPF continues to believe that the best way to build good practice in relation to DC default investment fund design, review and governance is not through more prescription or regulation. Instead, the focus should be to encourage better governance of DC schemes across the piece in both trust based and contract based models.
 - **Standards not Principles** - We believe that the DWP's intention to create standards with regard to default investment options is too narrow and ultimately counterproductive as it goes beyond helpful guidance. A 'one size fits all' standardised approach across the UK DC landscape is inappropriate as it does not recognise individual scheme characteristics eg different employee types and attitudes. We would prefer to see a more principles based approach – like that proposed by the Investment Governance

Group (IGG) in November 2010¹ – a high level approach which would allow a DC scheme to develop and move toward best practice.

- **Insufficient flexibility** - As DC provision is beginning to change it is also questionable whether the standardised approach advocated by the DWP is too inflexible. As a greater critical mass within UK DC provision is achieved and, more importantly, as providers translate new thinking into DC product development, it would be disappointing if an overly prescriptive approach to default fund design and review hampered innovation and future investment choice. In fact any restriction of this kind could potentially lead to worse outcomes for members.
- **Extension to trust based occupational DC pensions** – The extension of specific guidance to trust based DC schemes is overly prescriptive and unnecessary. Trustees have an overriding fiduciary responsibility to act in the interests of scheme members and beneficiaries and they will act in partnership with their professional advisers to do so. The NAPF believes that good DC scheme governance should be encouraged, but that this cannot be imposed through regulation.
- **Inappropriate sanctions** – It is particularly disappointing that the DWP have stated (paragraph 23 of the consultation document) ‘Adherence with this guidance will be monitored and regulatory steps taken at a later date if necessary’. In affect the DWP will potentially impose regulation if they believe compliance generally to be weak. Greater detail on how the DWP intend to monitor compliance, and against what criteria, would be particularly helpful to those with the responsibility for the oversight of default investment funds in DC pension schemes.

3. Conclusion

7. The NAPF has been foremost in arguing the case for a DC regime which will strengthen provision within the UK and help to produce good pension outcomes for scheme members. The NAPF believes that a debate on how such objectives can be met is important, and understands the underlying aims of what DWP are trying to achieve with this consultation. We do not accept, however, that a ‘one size fits all’ regulatory approach to be the most appropriate solution. Moreover, further regulation would appear to go against the commitment within the Coalition Agreement to reinvigorate occupational pensions and reduce administrative burdens on pension scheme sponsors.]
8. The NAPF believes a principles based approach to guidance, not further regulation, is the best way to improve standards in relation to DC default design and encourage better member outcomes for DC scheme members. If guidance is to be adopted then it should not be extended to trust based DC schemes given the specific fiduciary responsibilities of trustees.

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¹ IGG – *Principles for investment governance of work based DC pension schemes* (November 2010)

Consultation Questions

Workplace Personal Pensions being used for auto enrolment (Q's 1-8)

1. **Are the aims of this guidance clear?**

Yes. As drafted the guidance is intended to clarify that all 'qualifying DC schemes' used for auto enrolment under Pensions Act 2008 will be required to offer a default investment fund to all members.

2. **Would it be helpful to include examples illustrating how to create tailored default options to suit different employee profiles?**

Examples could be useful in helping to provide some context to different employee groups and member profiles, but such examples are unlikely to be able to cover all employee scenarios and if they become accepted as the norm they could become potentially misleading. Moreover, given the importance of the design of the default investment fund for qualifying schemes it is important that specialist professional investment advice regarding fund construction is obtained. Generic guidance – in the form of illustrative examples or otherwise – from the DWP or the Financial Services Authority (FSA) should only be regarded as additional background information.

3. **Is the definition of the default option accessible for readers?**

For clarity the definition of a default fund should make clear that the *pension funds* are the vehicles through which the investment within the scheme will actually take place.

4. **Bearing in mind the complex nature of responsibilities, is this description acceptable?**

Good governance can be delivered in a contract based or trust based DC arrangement. The NAPF believes that any initiative which sets out to map the key roles and responsibilities of all the various parties within the overall management of the default fund can be a useful exercise.

We are therefore strongly supportive of the IGG principles for DC governance which incorporate a breakdown of "who does what" with particular emphasis on the design and review of the default fund.

5. **Should specific examples of risk management strategies be provided?**

Risk management can cover a whole range of approaches and examples, while potentially helpful, could become too prescriptive if applied to all WPPs. The NAPF suggests that more narrative on the nature and types of investment risk, its likely impact and the importance of managing that investment risk would be more beneficial to recipients.

6. Have we sufficiently described the role of the risk management strategy in the default option and is it accessible for readers?

A first principles approach would advocate a clear definition of investment risk itself as the cornerstone of this section of the guidance. The reasons for a risk management strategy could then be set out with some useful examples of risk management in practice to provide emphasis as appropriate.

7. Does this section set out appropriate standards for reviewing the default option?

This section of the consultation document sets out a range of criteria for a review of the DC default investment option. The NAPF would argue that to define these criteria as standards is too prescriptive. Guidance should offer a suggested method of review rather than impose an inflexible standardised approach.

8. Does this section set out appropriate standards for communicating the default option?

We agree that communication regarding the default fund is important. The FSA's Conduct of Business Rules already prescribes what information must be disclosed at the point of sale for WPPs. Consequently the proposed introduction of further standards into the contract space is an unnecessary duplication of regulation.

Occupational Defined Contribution Pension schemes used for auto enrolment (Q's 9-12)

The NAPF reiterates its view that the extension of guidance to occupational DC schemes established under trust is an unnecessary and an overly prescriptive approach.

9. Is this an accurate reflection of the roles and responsibilities for trustees regarding the default option?

No. The fundamental point/issue within a trust based DC pension arrangement is that the trustees retain ultimate responsibility for all facets of DC default fund design. While it may be useful to record roles and responsibilities in terms of delegation to agents and providers, this should not confuse the fact that trustees retain the final responsibility overall.

10. Have we sufficiently described the role of the risk management strategy in the default option and is it accessible to readers?

This question is a restatement of question 5 in respect of WPPs and we direct you to our previous answer. Any description should be completely clear that under a trust based model risk management is ultimately a trustee responsibility.

11. Does this section set out appropriate standards for reviewing the default option?

We do not believe that trustees require a set of standards for the review of the default investment fund. Trustees will be most aware of their own objectives for their DC scheme and the importance of the default option within it. Trustees should therefore conduct their own review in accordance with their own guidelines or criteria and with the help of the scheme's professional investment advisers.

12. Does this section set out appropriate standards for communicating the default option?

As trustees can source information from their specialist advisers with regard to the communication of the DC scheme investment offering we do not believe that trustees require a set of standards to assist with the communication of the default investment fund.

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