NAPF

Securing the future of pensions

Enabling good member outcomes in work-based pension provision: a response by the National Association of Pension Funds

April 2011

NAPF
Securing the future of pensions

Contents

	Page
Executive Summary	**4**
Ten recommendations for securing good member outcomes in DC	**7**
1. About the NAPF	**9**
2. Introduction	**9**
3. The NAPF's vision for workplace pensions	**11**
4. Outcomes and risks in DC saving	**13**
5. Super Trusts: governance and scale	**20**
6. Regulating Super Trusts	**23**
7. Risk-sharing in a Super Trust environment	**25**
8. Good governance	**26**
9. Raising standards through the Pension Quality Mark	**29**
10. Answers to consultation questions	**31**

For further information, please contact:

James Walsh
Senior Policy Adviser: workplace pensions
National Association of Pension Funds
Cheapside House
138 Cheapside
London
EC2V 6AE
james.walsh@napf.co.uk

Executive Summary

This is a time of transformation in the UK's pensions landscape. The shift from defined benefit (DB) to defined contribution (DC) provision, together with the launch of auto-enrolment, will bring unprecedented numbers of people into DC pensions. This is the ideal time to ask whether the DC we have today will be fit for purpose tomorrow.

The UK used to have a pension system that was the envy of the world, but excessive regulation, recent stock market performance, improvements in longevity and changes to pensions accounting have all contributed to a continuing decline in DB pension provision.

The 2012 pension reforms are a good start and will make a real difference to people's retirement incomes. But the NAPF has long argued that we should go further. While auto-enrolment will help with the flow and get 5-9 million people saving or saving more into a pension, we now need to ensure that the UK pensions system delivers the outcomes all individuals need and want for their retirement.

Pensions work best when provided through the workplace. Employers are more trusted than the government when it comes to pensions, and providing pensions through the workplace ensures good reach, good governance and the potential to reap the benefits of economies of scale. But this is not always realised in today's pensions landscape and we have a legacy of small schemes in the UK. Average scheme membership in the UK stands at just 2,600, compared to 10,500 in the Netherlands and 27,000 in Australia.

Large-scale schemes are better able to keep costs low, while also having the resources to provide high-quality investment management, administration and communications. The Regulator is right to ask how small schemes can be helped to migrate into large-scale provision. While NEST will go a long way to bringing more people into workplace saving, the NAPF believes the development of Super Trusts must be encouraged if we are to ensure good member outcomes in DC and meet the Regulator's objective of consolidation to improve outcomes.

But what do good member outcomes look like in a DC world? The NAPF's view is that DC pensions need to deliver a retirement income that is adequate, secure and matches pensioners' income needs as they move through retirement. Achieving these good outcomes in retirement requires good decisions while working and saving, in particular over contributions, investment and how to turn a pension 'pot' into an income stream.

The risks in DC are many, and by design more of the risk falls on the employee or individual saving into a pension. Ultimately the key risk is about adequacy – will people get enough to live on in their retirement? But there are many factors contributing to this risk, including the risk of:

- individuals not contributing enough for their retirement;
- employees getting poor value for money from high charges;
- making poor investment choices; and
- making poor decumulation decision, particularly around the nature and timing of any annuity purchase.

Good workplace pensions should exhibit a number of features that protect members from these and other risks. These features include trust-based governance, economies of scale, and reach to those on low or moderate earnings who are least likely to save by other means.

Super Trusts would exhibit these features. Super Trusts would be high-quality, large-scale, not-for-profit, multi-employer pension schemes (offered on a regional, sectoral or national basis) managed by expert boards of trustees whose responsibility it would be to put the interests of members first. As such, Super Trusts would operate in a similar way to NEST. But, unlike NEST, they would have less direct government involvement.

Super Trusts would help to build a 21st Century pensions system that puts members first. The Pensions Regulator would be responsible for regulating Super Trusts, including authorising bodies wishing to run them and approving trustee appointments.

As well as scale, high-quality governance also needs to be a key feature in the future of DC pensions. Good governance addresses many of the key risks to members. It ensures the scheme is run in the members' interests, rather than those of the employer or the provider. Whatever governance model is chosen, such as a trustee board (in trust-based DC) or a pensions management committee (in contract-based DC), it will provide a group of knowledgeable and experienced people able to hold providers to account and to ensure that employers give the scheme the support they have promised.

But it is not just about scale and good governance. The move to DC has shifted risks from the employer to the employee and, as discussed in the EU's recent green paper on pensions, this has the potential to lead to sub-optimal outcomes. The NAPF believes that it should be easier to establish and run schemes in which risks are shared between employees and employers. To secure good member outcomes, the Regulator needs to move way from seeing pensions as solely DC or DB and embrace and encourage forms of risk sharing.

The Pensions Regulator has a crucial role to play in helping the Government to meet its commitment 'to reinvigorate occupational pensions' and in creating an environment in which high-quality DC schemes can flourish.

The Regulator should not rush to introduce new regulation; any new regulatory measures must be offset by measures that reduce burdens on pensions. Rather, the Regulator should develop a proportionate, risk-based approach that encourages innovation while ensuring members are well protected.

The whole pension sector needs to work to raise standards and improve outcomes. The NAPF is already playing its part through the Pension Quality Mark, which has now been awarded to over 100 schemes. We welcome the Regulator's focus on higher standards and we look forward to working together on ensuring good outcomes in the DC pensions of the future.

NAPF's ten recommendations for securing good member outcomes in DC

1. The Pensions Regulator should put high-quality governance and scale at the heart of its work on the future of DC pensions. Good governance is particularly important in DC pensions where more of the risk is with the member.

2. The Pensions Regulator should encourage the establishment and development of Super Trusts to bring scale and good governance to the workplace-based DC pensions of the future.

3. The Pensions Regulator should be responsible for regulating Super Trusts, including the authorisation of bodies wishing to run Super Trusts and the approval of trustee appointments.

4. In its approach to the risk for members of DC schemes, the Regulator should give a high priority to contribution risk. If contributions are too low, then securing good outcomes in retirement is almost impossible.

5. The Regulator should make low management charges a key priority. Its starting point should be a presumption that stronger governance and scale would help to address market failure and keep charges low.

6. Given the importance of decumulation decisions in ensuring pension saving is turned into good member outcomes, the Regulator should ensure a framework exists for promoting better consumer understanding of the options available to individuals on drawing their pension.

7. Given that most of the risks in DC lie with the member, it is essential that the Regulator promotes communications that engage members with their pension saving. Members should be encouraged to understand their pension arrangements and the choices available to them.

8. The Pensions Regulator should develop a proportionate approach to DC regulation based on Better Regulation principles. Any new regulatory measures must demonstrably improve member outcomes and must be offset by measures to reduce burdens on employers and pension schemes, in line with the Government's commitment to 'reinvigorate occupational pensions'.

9. The regulatory architecture should be simpler, with a single regulator for pensions. The FSA's responsibilities for Group Personal Pensions and Stakeholder Pensions (including point of sale regulation) should transfer to the Pensions Regulator. Prudential regulation for insurance companies and pension providers would remain with the new Prudential Regulation Authority.

10. The Regulator should develop an environment that promotes risk-sharing between employees and employers. It is not acceptable for employees to shoulder all the risks involved in saving for retirement.

NAPF
Securing the future of pensions

1. About the NAPF

1. The National Association of Pension Funds is the UK's leading voice for workplace pensions. Our members operate 1,200 pension schemes. They provide retirement income for nearly 15 million people and have almost £800 billion of assets under management. Our membership also includes over 400 providers of essential advice and services to the pensions sector. This includes accounting firms, solicitors, fund managers, consultants and actuaries.

2. The NAPF's members are involved in every aspect of defined contribution (DC) pension provision, from running DC pension schemes to managing investments to providing annuities. Many members participate in our *DC Pension Connection* – a network of nearly 1,000 people that brings members together in person and online to discuss the latest issues, challenges and solutions in DC provision.

2. Introduction

3. The NAPF welcomes the opportunity to respond to the Pensions Regulator's consultation *Enabling good member outcomes in work-based pension provision.*

4. We are at a time of transformation in the UK's pensions landscape and the NAPF shares the Regulator's view that this is a good time to review the DC pensions systems.

5. The UK used to have a pension system that was the envy of the world, but excessive regulation, recent stock market performance, improvements in longevity and changes to pensions accounting have all contributed to a continuing decline in DB pensions.

6. The continuing shift from defined benefit (DB) to DC provision is a key reason for a renewed focus on the strength and quality of DC pensions.

7. Today, just 21% of DB schemes in the private sector are open to new employees, compared with 88% ten years ago. Further rapid decline of DB is likely: 33% of schemes are planning to make changes for existing members, including reducing benefits or moving staff to DC arrangements.[1]

8. The auto-enrolment reforms to be introduced from next year provide a further reason for reviewing DC pensions. The reforms are a good start. They will help with the flow and

[1] NAPF Annual Survey 2010

get 5-9 million people saving or saving more into a DC pension. But we need to go further. We must ensure that people are able to save in a way that meets their needs for retirement income and delivers adequate outcomes.

9. DC is already a significant part of the UK pensions landscape:

- As figure 1 shows, DC pension provision in its various forms, including stakeholder pensions and personal pensions, accounts for 68 per cent of active employee members of pension schemes in the private sector, with DB accounting for 32 per cent.

- Looking at active, deferred and pensioner DC members together, there are 1 million DC memberships of hybrid schemes with a dual section, 1.5 million memberships of trust-based DC schemes and 3 million memberships of contract-based DC schemes.[2]

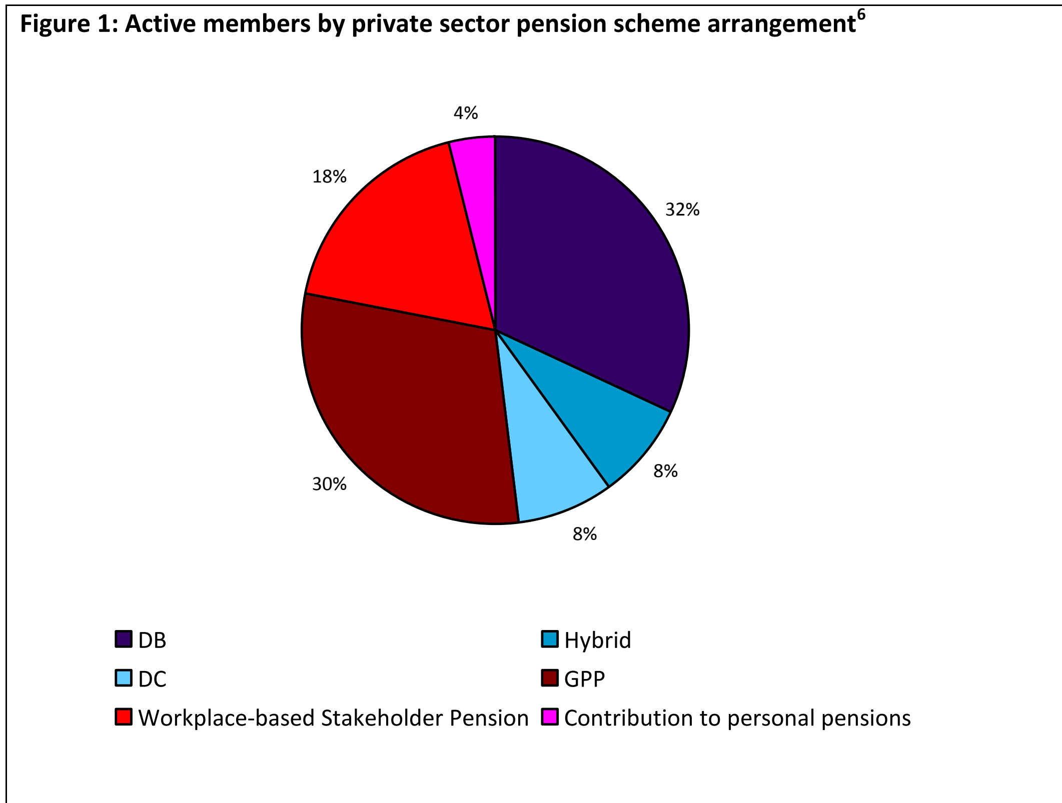
- Although it is difficult to estimate the overall size of the DC market,[3] the *Aon DC Tracker* estimates that, at the end of November 2009, DC schemes had £505 billion of assets under management.[4]

- In the four years between 2004 and 2008, the number of annuities sold in the UK rose from around 310,000 to 450,000 – an increase of 50%.[5]

10. DC is already an important part of our pensions infrastructure and is set to become even more significant. There could hardly be a more pressing case for asking whether our DC system is fit for purpose.

[2] *DC Trust 2010*, The Pensions Regulator. These figures are for all members, not active members only.
[3] For an overview of different measures, see DWP, Defined Contribution Pension Provision, 2009.
[4] Aon Press Release.
[5] DWP, Defined Contribution Pension Provision, 2009. NB This chart covers private sector employees but excludes the self-employed.

Figure 1: Active members by private sector pension scheme arrangement[6]



Source: Department for Work and Pensions*, Employer' Pension Provision Survey 2009*

11. This response sets out the NAPF's vision for workplace pensions. In particular, it shows what good outcomes for members of DC schemes should look like and gives the NAPF's assessment of the risks that can prevent members from achieving those good outcomes.

12. After giving an overview of the current state of the DC market, it goes on to show how these good outcomes can best be secured by the use of scale, good governance, risk-sharing and Better Regulation – attributes that can all be provided by the NAPF's model for the future of DC pensions – Super Trusts.

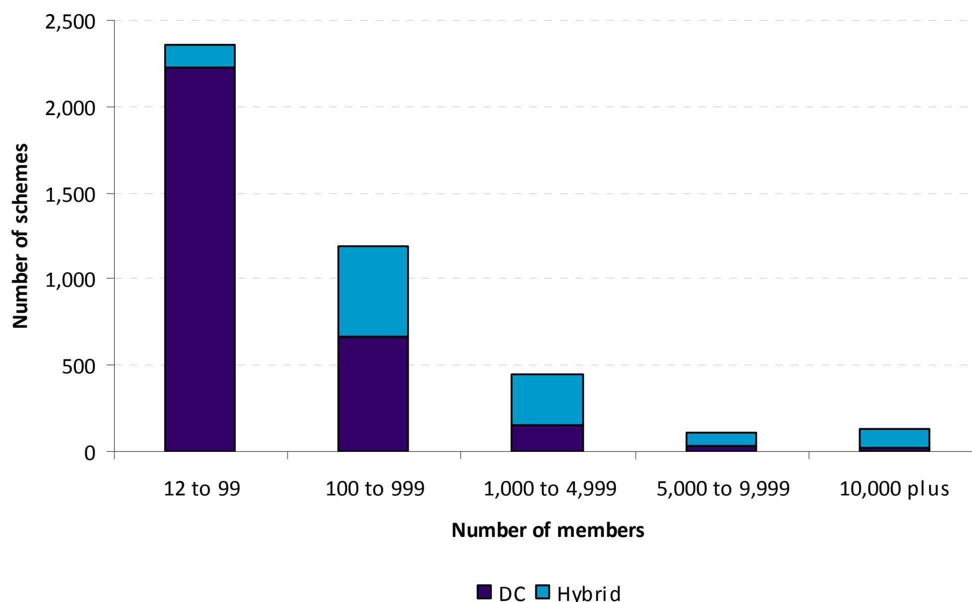
3. The NAPFs' vision for workplace pensions

13. Pensions work best when provided through the workplace. Employers are more trusted than the government when it comes to pensions (see box 1). Providing pensions through the workplace ensures good reach, good governance and the potential to reap the benefits of economies of scale. But this is not always realised in today's pensions

[6] Department for Work and Pensions, Employer' Pension Provision Survey 2009

landscape and we have a legacy of small schemes in the UK. Average scheme membership in the UK stands at just 2,600, compared to 10,500 in the Netherlands and 27,000 in Australia.[7]

Figure 3: Distribution of trust-based DC schemes by number of members



14. Large-scale schemes are better able to keep costs low, while also having the resources to provide high-quality investment management, administration and communications. Capita Hartshead's Pension Scheme Administration Survey 2009 shows that schemes with more than 50,000 members report costs of around £15-£20 per member, whilst schemes with fewer than 1,000 members report costs of around £150 per member.

15. Research from Spence Johnson shows that scale can be a powerful tool in ensuring effective member communications, not least because larger funds have the resources for creative and personalised campaigns.[8]

16. While NEST will go a long way to bringing more people into workplace saving, the NAPF believes the development of Super Trusts must be encouraged if we are to ensure good member outcomes in DC and meet the Regulator's objective of consolidation to improve outcomes. The NAPF's case for Super Trusts is developed on pp.20-26 below.

[7] UK Pensions Regulation Compared NAPF, October 2008. [Note: figures exclude schemes with fewer than 100 members.]

[8] *The Pension Communications Project 2010, Getting personal: Excellent DC communications from around the World*, Spence Johnson, 2010

Box 1: The strengths of collective workplace pension provision

- **Trust:** The 2008-9 economic crisis saw a collapse in consumer confidence in financial institutions including pensions. Yet throughout the crisis, working people continued to trust their employer over any other form of pension provider, including the State. According to the NAPF Workplace Pension Survey 2010, 28% of the individuals surveyed said they trusted their employer the most, while only 17% said they trusted the government the most.

- **Economies of scale:** Pensions that are provided wholesale through the workplace can generate economies of scale not available on a retail basis. Retail pensions are costly and inefficient, especially for low to moderate earners.

- **Reach:** Workplace pensions provide the only efficient way to reach low to moderate earners – those most at risk of not saving or under saving for old age.

- **Governance:** The move away from occupational pensions towards individualised, contract-based schemes has created a 'governance vacuum'. Without strong, independent, governance there can be no assurance that the scheme is operating in the members' interests, for example keeping costs low.

- **Risk-sharing:** Employer involvement can help to share risks. In DB schemes the risks are placed on the employer. But in DC schemes, especially contract-based schemes with no governance, the risks are placed entirely on the members who are generally ill-placed to assess and manage those risks. Ultimately, shifting all risk onto individuals may prove unsustainable.

4. Outcomes and risks in DC saving

17. The NAPF shares the Regulator's objective of achieving good outcomes for members of DC pension schemes. Good outcomes in DC saving would include:

- an adequate retirement income;

- a private pension income that matches pensioners' changing income needs as they move through retirement; and

- a private pension income that is secure, with the member safeguarded against risks such as the collapse of their pension provider.

18. If these very high-level objectives are to be achieved, then members and those running their pension schemes have to get a series of decisions right. These decisions will cover issues such as contributions, investment and decumulation. Good decision-making on matters such as administration, ensuring pensions are secure and safeguarding members from political risk will also play an important part in determining whether members enjoy good outcomes in retirement.

Contributions and charges

19. If too little is saved into the pension 'pot', then there is little prospect of a good outcome in retirement, no matter how good other decisions might be on matters such as investment or choice of annuity.

20. The choice of contribution rate can have a major impact on outcomes. As the table below shows, 40 years of contributions at the minimum level required under auto-enrolment (8 per cent) would deliver an annual retirement income over £2,000 lower than if contributions had been made at the 10 per cent level required for award of the NAPF's Pension Quality Mark.

Table 1: Annual incomes in retirement resulting from contribution rates of 8% and 10%

Contribution rate	Contribution years	Size of pension pot	Annual income
8%	**20**	£54,426	£3,701
	30	£104,604	£4,916
	40	£178,842	£8,405
10%	**20**	£68,033	£3,197
	30	£130,756	£6,145
	40	£223,552	£10,506

Based on median earnings growth of 2.5%, charges of 0.5% and an annuity rate of 6.8%

21. DWP research shows that the average contribution rate into a DC pension (from employee and employer combined) is 11 per cent. This compares with 24 per cent in defined benefit schemes.

Table 2: Average employer and employee contributions by scheme type[9]

Type of scheme	Average employer contribution	Average employee contribution
Defined contribution	7%	4%
Defined benefit	17%	7%

Source: *Employer's pension provision survey*, DWP, 2009

22. A key part of the contributions debate is the issue of charges. High charges can result in substantially lower pension pots and, therefore, lower incomes in retirement.

23. The compounding effects of pension investment mean that a few extra basis points in charges can make a major difference to the size of a pension pot at the end of a working life of saving.

24. Table 3 below shows the difference that management charges can make. Based on a median earner, with 2% earnings growth over the years, contributing 11% of his salary and an annual investment return of 3.5%, it shows that management charges of 0.3 per cent would deliver over £3,000 extra annual income in retirement, compared with a scheme in which the management charges were 1.2 per cent.

Table 3: the impact of Annual Management Charges

AMC (%)	**Final pot (£)**	**Annual income (£)[10]**
0.3	256,966	17,474
0.7	235,430	16,009
1.2	211,565	14,386

25. In theory, competition should keep management charges low, just as competition bears down on prices in other parts of the economy. However, it is clear that competition is not working efficiently in pensions. This is the result of a combination of factors, chiefly

[9] *Employer's pension provision survey*, DWP, 2009
[10] Assumes purchase of a single life level annuity for a 65 year old male at 6.8%.

consumer inertia and the complexity and lack of transparency associated with pension charges. This is an area of market failure that clearly needs to be addressed.

26. The NAPF does not propose regulatory solutions. Rather, as we argue elsewhere in this submission, the solution lies in stronger *governance*: if trustees or other bodies charged with acting in the interests of members were to put providers under greater pressure to justify their fees, then the result would be significant downwards pressure on charges.

27. The NAPF is also working to keep charges low through the standards required for the Pension Quality Mark, which requires average charges of one per cent or less.

Recommendation: In its approach to the risk for members of DC schemes, the Regulator should give a high priority to contribution risk. If contributions are too low, then securing good outcomes in retirement is almost impossible.

Recommendation: The Regulator should make low management charges a key priority. Its starting point should be a presumption that stronger governance and scale would help to address market failure and keep charges low.

Investment

28. Investment *choice* is crucial to successful outcomes in DC pensions. Poor decisions in this area mean that pots and the pensions they provide turn out lower than members expect.

29. Of course, most members do not make investment decisions at all, as the DC investment landscape is dominated by the default fund.

30. The NAPF Annual Survey 2010 found that 91 per cent of schemes offered a default fund and, where a default fund was offered, 83 per cent on average of members remained in it. This extensive use of the default fund is despite (or perhaps because of) the fact that contract-based DC schemes offered an average of 44 investment options.

Security

31. For many savers, pensions ‘security’ means the investment performance issue discussed in the previous paragraph. For others it means the question of whether their savings are safeguarded against criminality or poor management. Past episodes such as the Maxwell

scandal and the collapse of Equitable Life still feature in people's concerns about pensions.

32. The Fraud Compensation Fund, run by the PPF, provides compensation to members of occupational schemes who suffer financial losses due to dishonesty.

33. Members of DC schemes have protection against the insolvency of their provider through the Financial Services Compensation Scheme, which provides 90% compensation, with no upper limit, for investments lost as a result of a provider company declared 'in default'. For claims arising before 1st January 2010, payments are 100% of the first £2,000, plus 90% of the remaining claim.

34. The FSCS paid out £13.5 million in life or pensions-related insurance compensation in 2009-10.

35. Many savers are also worried about the risks arising from poor investment performance and the DC pensions of the future should provide some protection and reassurance on this front. This could be achieved through better governance and through dynamic investment decisions that 'hedge out' downside risk. A further possibility would be a guarantee that the pension pot would not fall below a certain level, although there are pros and cons to this approach – an issue discussed in more detail below (see paras. 67-8).

Decumulation decisions

36. Many of the most significant risks in DC pensions surround the decision on how to turn a pension pot into the most suitable income for retirement. This is perhaps the point in the retirement saving 'journey' at which members are at their most exposed – being asked as laypersons to take complex decisions that would challenge even experienced financial professionals.

37. This challenge is compounded by the small size of the pots with which most people are working. In 2008, the mean size of the pot used for annuity purchase was £26,000.

38. At *current* annuity rates[11], this would generate an annual income of just £1,800 (in the case of a 65 year-old single male purchasing a level, single-life annuity).

[11] The DWP's analysis shows that annuity rates for a male aged 65 were 7.92 per cent in July 2008 but by February 2011 they had fallen to 6.86 per cent (*Defined Contribution Pension Provision 2009*, DWP, and Annuity Bureau).

39. Despite these figures, pot sizes are steadily increasing as the DC sector becomes more mature. As recently as 2000, the mean pot used for annuity purchase was £20,800, so there had been a rise of more than £5,000 in just eight years.

40. We also need to see improvements in the way in which people go about purchasing an annuity. Many savers still do not take the opportunity available under the Open Market Option to shop around. Only 67 per cent of people shop around for their annuity, with 32 per cent subsequently purchasing an annuity from a provider other than the one that provides their pension.[12] Further steps should be taken to encourage shopping around. The Regulator should also consider what it can do – in conjunction with providers – to make it easier for people to move 'pots' from one provider to another, for example, when they change jobs.

Recommendation: Given the importance of decumulation decisions in ensuring pension saving is turned into good member outcomes, the Regulator should ensure a framework exists for promoting better consumer understanding of the options available to individuals on drawing their pension.

Recommendation: Given that most of the risks in DC lie with the member, it is essential that the Regulator promotes communications that engage members with their pension saving. Members should be encouraged to understand their pension arrangements and the choices available to them.

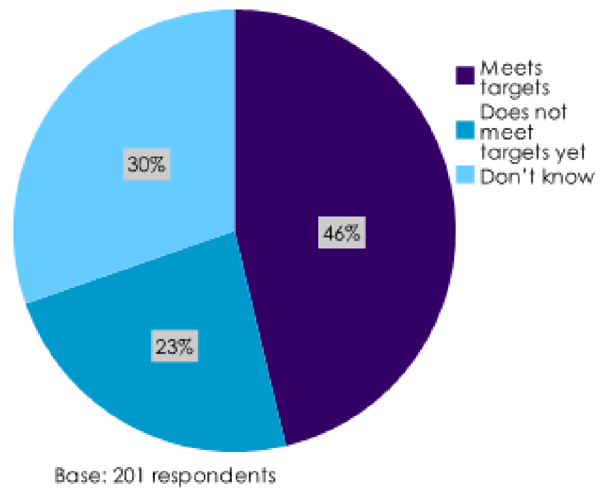
Administration

41. Administration needs to be consistently good in DC pensions. It is essential that the right amount of contributions for each member is promptly invested every single month. Members have to be kept up to date on their pension saving through good communications. If any of these tasks goes awry, then members are very likely to miss out, either because they 'lose' money that should be invested in their name or because they are not encouraged to engage with their retirement saving as actively as they might.

42. The Regulator has recently set targets for record-keeping, which include requiring that at least 95% of legacy records have all the key data available in one place. The NAPF's Annual Survey 2010 shows that many schemes (46 per cent) already meet this target, but that some do not.

[12] *Annuity Purchasing Behaviour*, ABI research paper no.23, 2010

Figure 2: Meeting the Regulator's legacy data targets



43. 43% of members surveyed said the Regulator was right to take action, but 18% thought that getting the Government to ensure its National Insurance records are accurate should be a bigger priority.

Political risk

44. Pensions need a stable legal, regulatory and taxation framework that gives people certainty and confidence that they can save without a future government 'moving the goalposts' or undermining their saving with unexpected regulatory changes.

45. Unfortunately this is far from being the case in pensions. Since 1995 there have been over 850 pieces of legislation or regulation relating to workplace pensions– roughly one a week.

46. So a good outcome in this area would be to secure the right regulatory framework and then to give it stability over the long term.

5. Super Trusts: governance and scale

47. Having summarised the good outcomes that we would ideally want to see and the factors that could put them at risk, we can now consider how to go about securing them.

48. The DC of the future needs two key elements – better *governance* and more s*cale.* Both can be provided through 'Super Trusts' – large-scale, multi-employer schemes with strong governance arrangements.

49. Good governance ensures that members' interests are properly represented so that they secure the best possible value for their pension savings. And it ensures they have the support they need as they build up pension savings for the future – particularly as they are faced with key decisions over investment and annuity choices. Super Trusts would provide a model of high-quality governance.

50. Super Trusts would also provide scale. The NAPF has long argued that there would be much to gain from helping small schemes to migrate into large-scale, well governed provision, and we are pleased to see the Regulator raising the issue in the present consultation.

51. Super Trusts would be offered on a regional, sectoral or national basis and managed by an expert board of trustees whose job would be to put the interests of members first. As such, Super Trusts would operate in a similar way to NEST. But, unlike NEST, they would have less direct government involvement. To ensure that Super Trusts reached scale, they should be limited in number – no more than 20, each licensed to operate by the Pensions Regulator.

52. Super Trusts need not simply be for future accruals. They would be ideal vehicles for consolidating the many single-employer DC schemes already in operation. By consolidating under the umbrella of a Super Trust, scheme sponsors would be able to put their scheme on a more efficient footing. Scheme members, in return, would find more of their money working for them.

53. Fewer, larger, schemes could also provide the opportunity for a 'regulatory dividend' – a reduction in the overall costs of regulation as the Regulator focuses more efficiently on fewer, larger schemes.

Box 2: Super Trusts – delivering good outcomes through scale

- Super Trusts would be large-scale, low-cost, DC pension arrangements.

- NAPF modeling suggests that Super Trusts could operate at around 40bpts. They would have the potential to remain low-cost due to their independent governance and buying power resulting from their scale.

- Built around auto-enrolment, Super Trusts would achieve high levels of coverage. Since employers would have a more clearly defined role, and because members would not be faced with a bewildering level of complex and off-putting choices, levels of opt-outs might remain lower than for other forms of pension.

- Super Trusts would be based around good scheme governance, guaranteeing high levels of consumer protection, putting the interests of scheme members, and not commercial interests of providers, first - reinforced by their not-for-profit status.

- By providing a pooled approach to scheme investments, Super Trusts could offer members lower investment risks. Members would share in a fund (and its returns) that would be invested in a basket of assets for growth and security.

- Super Trusts would provide upside opportunities whilst managing downside risk by applying the Super Trust's investment and governance expertise to asset allocation and investment strategy.

- Super Trusts would provide some diversity in the market place. Employers would choose the appropriate Super Trust for them and their employees. Super Trusts would also help to ensure that the costs and services provided by NEST were competitive and high quality.

Super Trusts explained

54. Super Trusts would operate on the 'buy side' of the market, purchasing services (including scheme administration and fund management) from providers on behalf of members. Contracts would be awarded on the basis of cost and quality of service. Trustees would renegotiate and re-let contracts periodically to help drive improved

performance and efficiency in the market. This would ensure that Super Trusts were run in the interests of scheme members and not commercial providers.

55. Super Trusts could be established by a range of entities, including existing multi-employer schemes, trade associations and affinity organisations. But in order to ensure that Super Trusts were successful, and had the confidence of scheme members and their participating employers, the Pensions Regulator would need to set controls on the organisations that could establish a Super Trust.

56. The Regulator would also have the power to de-authorise Super Trusts that failed to meet the required standards.

57. The performance of each Super Trust would be fully transparent. Super Trusts would be accountable to the Pensions Regulator for their costs and charges, overall investment performance, risk management and quality of service to members. They would publish annual reports stating their performance in these areas in standardised formats so performance between Super Trusts could be compared and contrasted.

58. Once auto-enrolment is in place, employers will be required to enroll their employees into a workplace-based pension scheme – either an ‘in-house’ scheme or NEST. In the NAPF’s vision, Super Trusts would sit alongside NEST, providing employers with a choice of schemes for their employees.

59. Details of each Super Trust would be available on the Pension Regulator’s website and the joining process would be low-cost, with employers completing a simple application form.

Super Trusts: better for employees

60. Employees would be automatically enrolled into the Super Trust selected by their employer. Unless they opted out, they would be required to make the minimum level of contributions set by the Government.

61. Each Super Trust member would have their own personal Super Trust Account (STA) and would receive an annual statement setting out: the contributions paid into the scheme over the past 12 months; total contributions paid; current value of pension fund; and the income this could give in today’s prices.

62. When moving to a new employer who was affiliated to a different Super Trust, the member would be required to transfer their Super Trust Account to the new Super Trust.

This would give individual savers 'lifetime pots' and would reduce the proliferation of small accounts whose value is eroded by charges.

Super Trust investment strategy

63. Super Trusts would adopt a pooled investment approach. Individuals, who generally take poor investment decisions or who find the prospect of making a choice so overwhelming they are deterred from saving, would not be required to take individual investment decisions. Instead, decisions would be taken by trustees, on advice from investment experts.

64. Trustees would set and publish an investment strategy and would select a number of managers to invest the fund. Super Trusts would pool risks across their member populations by investing in different classes of assets, taking account of the need to optimise overall returns for members while at the same time reducing individuals' exposure to market risk. Within these pooled arrangements, individuals would have their own individual 'units' or Super Trust Accounts. This would help build a sense of ownership of the pension asset and encourage pension saving.

Recommendation: The Pensions Regulator should encourage the establishment and development of Super Trusts to bring scale and good governance to the workplace-based DC pensions of the future.

6. Regulating Super Trusts

65. The advent of Super Trusts would require a completely new regulatory structure for DC pensions. In a Super Trust world there would be a small number of large-scale, professionally run bodies to supervise, compared to the current environment in which the Regulator finds itself regulating many thousands of individual schemes – some of them small and lacking economies of scale... So the regulatory regime would be simpler. It would also be transparent to consumers.

66. The Pensions Regulator would be responsible for authorising Super Trusts. We envisage no more than 20 Super Trusts would be authorised. In order to ensure that Super Trusts were established by organisations that had the potential to run successful schemes the Pensions Regulator would need to set the eligibility criteria for organisations that could establish Super Trusts.

67. The Regulator would operate a filtered authorisation process which could operate as follows:

    - The Pensions Regulator would invite expressions of interest from those interested in establishing Super Trusts.
    - Applications that did not meet the Regulator's criteria would be filtered out at this early stage.
    - Remaining applicants would be invited to submit full business plans.
    - The Regulator would then select the final Super Trusts based on the strength of their business plans and the quality of the proposed Super Trust personnel.
    - The Pensions Regulator would also approve the appointment of individual Super Trust trustees. In doing so, the Regulator would have regard to the fitness, competence and expertise of the trustees. The Regulator would also keep a register of approved trustees.

68. Ultimately, the Pensions Regulator would have the power to de-authorise Super Trusts that did not operate in the interests of scheme members, for example by failing to provide an adequate level of service to scheme members or failing to keep costs low.

69. In advance of closing a Super Trust down, the Regulator could impose new management (much as the Regulator can do with failing schemes currently). This would provide scheme members with continuity of membership, whilst at the same time ensuring that there was a governing body in place that would act in the members' best interests.

70. The Pensions Regulator would be responsible for moving the members of a de-authorised scheme to a new Super Trust.

71. The Pensions Regulator's whole approach should be governed by the principles of Better Regulation. These require a proportionate, risk-based style of regulation. The Regulator should also abide by the Coalition's commitment to a 'one in, one out' approach, meaning that the introduction of any extra item of new regulation should be balanced by the removal of one of the same (or preferably greater) impact on pension schemes, employees and employers.

72. There should be a single regulator for pensions. The current structure is difficult to justify, makes little sense to scheme members, and opens up the possibility for regulatory arbitrage or duplication. The regulatory architecture should be simpler and slimmer. The NAPF proposes that the Pensions Regulator should have responsibility for regulating all kinds of workplace pensions; at present Group Personal Pensions and Stakeholder Pensions are covered by the Financial Services Authority.

Recommendation: The Pensions Regulator should be responsible for regulating Super Trusts, including the authorisation of bodies wishing to run Super Trusts and the approval of trustee appointments.

Recommendation: The Pensions Regulator should develop a proportionate approach to DC regulation based on Better Regulation principles. Any new regulatory measures must demonstrably improve member outcomes and must be offset by measures to reduce burdens on employers and pension schemes, in line with the Government's commitment to "reinvigorate occupational pensions".

Recommendation: The regulatory architecture should be simpler, with a single regulator for pensions. The FSA's responsibilities for GPPs and Stakeholder Pensions (including point of sale regulation) should transfer to the Pensions Regulator. Prudential regulation for insurance companies and pension providers would remain with the new Prudential Regulation Authority.

7. Risk-sharing in a Super Trust environment

73. Super Trusts would transform the prospects for providing pension schemes in which risks are shared between employers and employees.

74. The progress on risk-sharing hitherto has been disappointing. When altering their pension arrangements, scheme sponsors have instead tended to switch straight to DC provision.

75. This move to DC has shifted more risk from the employer to the employee and, as set out in the EU's recent Green Paper on pensions, this has the potential to lead to sub-optimal outcomes.[13]

76. At present, the scope for risk-sharing arrangements is limited. Schemes that combine features of DB and DC tend still to be subject to the full panoply of DB regulation, so there is little regulatory easement unless the scheme is turned into 'pure' DC.

[13] *Towards Adequate, Safe and Sustainable European Pension Systems,* European Commission, July 2010

77. The NAPF believes that it should be easier to establish and run schemes in which risks are shared between employees and employers. To secure good member outcomes, the Regulator needs to move way from seeing pensions as solely DC or DB and should view types of provision along a risk spectrum that gives scheme members greater choice and flexibility. In short, the Regulator should embrace and encourage forms of risk-sharing as a way of improving member outcomes.

78. The sharing of these risks could be achieved in a number of ways, including through guarantees, either of annuity rate or investment:

- A guaranteed annuity rate would remove members' uncertainty about the amount they would need to save in order to be able to secure the kind of income level they wish to have in retirement.

- A guarantee on investment would put a floor under the fluctuation of DC investments. This might, for example, mean guaranteeing that the member's 'pot' would – at the very minimum – be equal to the sum of contributions paid. Similarly, there could be a guarantee of the return to be achieved on investment. This kind of outcome could be achieved through a hedging strategy that would mitigate 'downside risk'. There would, of course, be a cost to employers or pension scheme members – just as any other kind of insurance requires a premium to cover the risk.

79. This is where Super Trusts would make a difference. Their sheer scale would provide opportunities for dynamic investment strategies that would minimise both downside risk and the prospect of extreme outperformance. So members would have greater confidence about the size of 'pot' that a lifetime of pension saving would generate. This would provide a degree of certainty for savers.

Recommendation: The Regulator should develop an environment that promotes risk-sharing between employees and employers. It is not acceptable for employees to shoulder all the risks involved in saving for retirement.

8. Good governance

80. High quality governance also needs to be a key feature in the future of all forms of DC pensions, whether they be Super Trusts or contract-based arrangements. Good

governance addresses many of the key risks to members, including those relating to contributions, investment decisions and administration.

81. Without good governance arrangements in place, members will be on their own as they face the series of very challenging decisions that DC pensions require them to take. In DC, members have to decide:

- how much to pay into their pension;
- what kind of funds or vehicles they should choose;
- how they should adjust those investments throughout their working life; and
- how to turn their pension pot into income as they reach the end of their working life – or scale back their working commitments.

82. Each of these decisions has a direct and very significant bearing on the member's income in retirement, but most members are – through no fault of their own - poorly equipped to take them. Super Trusts would provide a system of governance that either takes these decisions for members or gives members the help and support they need to have the best chance of getting these decisions right.

83. The key difference between trust and contract-based pensions is the strong scheme-level governance that trustees provide. This governance provides significant benefits and protection for members. The benefits of good governance in trust-based schemes include:

- the ongoing monitoring and assessment of investment fund performance, with fund options removed if the trustees decide they are no longer appropriate;
- the ability to review and improve the default fund, both for existing and future members;
- an independent focus on keeping charges and costs low for the benefit of members. In 77% of trust-based DC schemes the employer either pays all charges or subsidises the charges for members;[14]
- communications from a trusted source and tailored for the workforce; and
- protecting and balancing the needs of both active and deferred scheme members.

84. Contract-based provision can also have good scheme-level governance. Many NAPF members have chosen to introduce management committees, which take on many of the roles of trustees. These governance structures are recognised as good practice by the Pension Regulator and by the NAPF's Pension Quality Mark. However, they are

[14] *Charging levels and structures in money-purchase pension schemes: Report of a quantitative survey*, DWP Research Report 630, 2010.

purely voluntary and their use is not widespread except by very large employers. The NAPF believes the 'governance vacuum' in most contract-based workplace pensions is one of the biggest long-term risks facing pension saving, and has the potential to undermine the Government's pension reforms.

Filling the 'governance vacuum'

85. The standards used for the NAPF's Pension Quality Mark (PQM) standards provide a useful guide to how the DC 'governance vacuum' can be filled. They set out three options for good governance:

- trustees;
- a management committee; or
- an annual review

86. These models are not enough in themselves. They simply provide a framework for a series of actions that deliver good governance. For example, the PQM standards require trustees or management committees to:

- meet regularly to discuss the pension scheme, with notes taken of the issues raised and decisions taken;
- receive relevant training; and
- review key issues relating to how the scheme is run and whether it is meeting its members' needs. These issues are set out in box 4.

Box 3: Pension Quality Mark standard B3:
Good practice list of issues to be regularly reviewed in a DC Scheme

- The effectiveness, accuracy and cost of the administration (whether in-house, third party or by a pension provider), including internal control mechanisms.
- The performance and charges of the fund managers.
- The appropriateness and range of the investment choices offered, particularly the default fund.
- The effectiveness and accuracy of member communications and information.
- The level of employee engagement, including the level of take-up and the level of employee contributions (particularly where these are voluntary or flexible).
- The adequacy of the processes and support for members approaching

retirement, including take-up of the Open Market Option.

- The overall level and structure of the charges, both for current and former employees, and how well these charges are communicated to employees.
- Relevant changes to legislation, regulation or tax rules.

87. Where there are no trustees or management committee, good governance can still be provided through a 'Scheme Review' to check that the scheme is meeting members' needs. The review should:

- be at least annual;
- involve consultation with scheme members (for example, through a staff survey);
- receive input from someone with substantial pensions understanding, such as someone with a relevant qualification; and
- cover the good practice issues in box 4 above.

Recommendation: The Pensions Regulator should put high-quality governance at the heart of its work on the future of DC pensions. Good governance is particularly important in DC pensions where more of the risk is with the member.

9. Raising standards through the Pension Quality Mark

88. Although this submission argues for changes to the DC landscape to improve outcomes for people, there is still much that can be done within the existing framework. The NAPF is making a major contribution through the Pension Quality Mark (PQM) an initiative that rewards and promotes high standards in DC pensions.

Box 4: PQM - the key features

The PQM is available for defined contribution pension schemes whether occupational, GPP or stakeholder which meet three basic criteria:

- Contributions of at least 10%, with a minimum employer contribution of 6%. Pension Quality Mark Plus is available where contributions are at least

15%, with a minimum employer contribution of 10%.
- Governance arrangements must be in place to ensure the scheme is operating in the best interest of members.
- Communications to members must be clear, engaging and easy-to-understand.

Reasons why employers apply for PQM:
- promote confidence in the company pension scheme
- attract and retain high calibre employees
- encourage employees to save for retirement
- benchmark scheme against competitors
- demonstrate they are a responsible employer
- prove the company pension scheme is a benefit worth having

89. The PQM was launched in 2009 and has become widely recognised within the pensions, employee benefits and IFA communities as a benchmark of good quality.

90. Over 100 schemes have now achieved the PQM standards and around 170,000 people are now saving in pensions schemes that hold the PQM.

91. As argued earlier in this response, a good level of contributions is the *sine qua non* of DC pension saving. As table 4 below shows, the contribution levels required for the Pension Quality Mark make a very substantial difference to the total amount saved into the pension.[15]

Table 4: comparison of contribution levels required for PQM and PQM Plus with auto-enrolment			
Contributions	**On total pay[16]**	**On 90% of total pay[2]**	**On qualifying earnings**
10%	60% more	44% more	25% more
15%	140% more	116% more	88% more

[15] Assumptions are based on median earnings
[16] Total pay means basic pay, overtime, bonuses, shift allowances and any other pay not defined as benefits in kind

10. Answers to consultation questions

Answers to the specific questions in the consultation paper are below.

Q1. Do you agree with the Regulator's 6 elements of good DC provision? What additional elements, if any, are important?

The NAPF agrees that the six 'elements' listed are all key factors in securing good outcomes from DC pension saving. We would add two further points.

First, the key factor from which all six 'elements' flow is good governance. The importance of good governance cannot be overstated, as it is this that provides the best possible chance of all six elements falling into place.

Good governance should not be solely for active members. It also needs to ensure that the interests of deferred members are well represented (for example, in terms of good investment decisions, good administration and value for money).

Second, a seventh element should be added to the list – education and financial capability. There is no single 'magic bullet' solution that would transform the average member's understanding of their pension, but good communication and information from the scheme can make a difference. The Government is playing a part through funding the Personal Finance Education Group, but we need to go much further.

All parts of the pensions sector need to be involved in developing more effective communications and educational material. This collective effort should involve the DWP, the Pensions Regulator, pension schemes, providers and employers.

Q2. Do you agree with the Regulator's assessment of the strengths and weaknesses of each of the identified segments of pension provision? If not, please set out your reasons and any evidence.

There are aspects of the Regulator's assessment with which the NAPF disagrees.

For example, the Regulator strikes a negative note about multi-employer schemes with non-associated employers, but many of these schemes have all the benefits of scale, strong governance and highly professional management set out in the earlier sections of this response – a point acknowledged by the Regulator in the consultation paper, where it notes 'multi-employer occupational pension schemes with non-associated employers have the

potential to be able to deliver good member outcomes very effectively, for example through being able to achieve governance expertise and economies of scale'.[17]

We are particularly concerned that the Regulator has attributed the lack of engagement of some employers in these schemes to the multi-employer nature of the schemes themselves when, in fact, the problem lies with some specific employers.

The NAPF sees the situation very differently. In our view, employers would chose to enrol their employees into a Super Trust not because they wish to have as little as possible to do with their employees' pension arrangements, but because they judge that this kind of high-quality pension will deliver business benefits in terms of recruitment and retention. We expect Super Trusts to attract employers who recognise the value of good pension provision and want to be engaged with it.

Q3. What can be done to help those making decisions about DC pension schemes to better understand the regulatory safeguards that apply to different types of pension arrangement? Were you aware of these differences before reading this document?

The NAPF agrees that it is important for those setting up or running pension schemes to have a good understanding of the different ways in which they are regulated.

The current structure is complex and confusing, not least because of the overlapping responsibilities of the Pensions Regulator and the Financial Services Authority in the regulation of Group Personal Pensions and Stakeholder Pensions. Simplifying this structure would contribute to helping 'those making decisions about DC'.

The NAPF would propose two changes.

- First, there should be a single regulator for pensions. The current structure is difficult to justify, makes little sense to scheme members, and opens up the possibility for regulatory arbitrage or duplication. The regulatory architecture should be simpler and slimmer. The FSA's responsibilities for GPPs and Stakeholder Pensions (including point of sale regulation) should transfer to the Pensions Regulator. Prudential regulation for insurance companies and pension providers would remain with what will soon become the Prudential Regulation Authority.

[17] *Enabling good member outcomes in work-based pension provision*, The Pensions Regulator, January 2011, para. 58

- Second, the single regulator must also be the right regulator. At present, the Pensions Regulator is charged with five statutory objectives:

  - to protect the benefits of members of work-based pension schemes;
  - to protect the benefits of members of work-based *personal* pension schemes;
  - to reduce the risk of situations arising that might lead to claims for compensation from the Pension Protection Fund;
  - to ensure employers comply with the requirements of the new system of auto-enrolment into work-based pensions, to be introduced from October 2012; and
  - to promote good administration of work-based pension schemes.

In practice, it is the third of these objectives that dominates the Regulator's activities. This leaves the Regulator overly focused on managing the 'end-game' for defined benefit pensions and insufficiently focused on the continuation of good-quality workplace pensions – including DC.

The Regulator's activities should be refocused on ensuring the longevity and health of workplace pension schemes. To give it this focus, the Regulator should have a new, additional, statutory objective: *to promote the provision of good pensions and to ensure their health and longevity.*

Although this new objective is primarily aimed at changing the way the Regulator regulates DB, it would provide a foundation for the way the Regulator addresses DC – by providing a regulatory environment that protects scheme members while keeping burdens on schemes to a minimum and allowing innovations that ensure pensions meet the needs of the future.

In following this new objective, the Regulator should ensure that it maintains a strong focus on DC issues as well as on the DB concerns that have been its primary focus over the last few years. The present consultation gives a welcome indication that DC issues are now much higher on the Regulator's agenda, and this must continue.

Q4. How can costs be reduced and governance improved in small schemes to encourage better member outcomes?

Q5. Given the evidence of the benefits of scale and good governance, should small schemes be encouraged to migrate into well-governed, large-scale provision? If so, how?

The NAPF is sympathetic to the thrust of the Regulator's argument on the difficulties faced by small schemes. We agree that the UK's pension system has an unusually long 'tail' of these schemes – an issue explored on pp.11-12 above.

We agree that there would be merit in helping small schemes to migrate into large-scale, well governed provision. The NAPF advocates moving all their members into completely new 'Super Trust'-type models – large-scale, multi-employer schemes with strong governance arrangements.

As we explain above in our exposition of the benefits of Super Trusts, these new institutions would deliver high-quality, trust-based governance at a low cost to the member, with Annual Management Charges around 0.4 per cent. The buying power that their scale would generate would enable them to provide top-quality investment and communications.

Super Trusts would deliver a pooled approach to investment that Super Trusts, reducing investment risk and again delivering better value for money. The trustees would be highly experienced experts, well placed to take the best possible decisions on behalf of the members. And by providing some diversity in the market place, Super Trusts would help to ensure that costs and services provided by other schemes – including NEST – would be competitive and of high quality.

Q6. Do you agree with our assessment of the strengths and weaknesses of multi-employer occupational pension schemes with non-associated employers? If so, what additional action do you suggest the regulator should consider taking?

We are concerned that the Regulator is taking an unduly negative view of multi-employer DC schemes with non-associated employers. In fact, the root of the problem identified in the preamble to this question is not that these schemes are multi-employer, but that some employers are not as closely engaged as they might be.

We emphasis again that governance has a key role to play. The Super Trust model that the NAPF advocates would benefit from independent, expert trustees who would ensure employers meet their commitments to the scheme.

Q7. What are the most important product characteristics of DC pensions which determine good member outcomes?

The key characteristics of good DC schemes are:

- *strong contribution levels* – because without this there is no chance of a good outcome;
- *low charges* – because low charges leave more money invested for future growth;
- *good governance arrangements* – because they ensure there is someone working to ensure the members' interests are protected;
- *strong engagement with members and employers* – because this promotes better decisions by both parties;
- *simplicity* – because this helps to keep costs low and makes pensions easier to understand for employees and employers;
- *investment tools and options that increase the likelihood of the desired outcomes*, eg, by hedging out downside risk – because this increases the chances of delivering the retirement income that members want and expect; and
- *an emphasis on educating and informing members about their pension saving* – because members are more likely to value their pensions. This is good both for employers and (because they are more likely to take good decisions) for employees as well.

There are other features that could be added to this list. For example, some schemes conduct regular reviews of semi-dormant members. But this is perhaps better viewed as best practice rather than as a 'core' characteristic of a good scheme.

Q8. How can the Regulator, or others, best encourage suppliers to ensure the presence of these characteristics in their products?

This is best achieved by pressure on the demand side, rather than by regulation. So – once again – the key element is good governance.

Whatever form this might take - whether trustees or a management committee or annual review - strong governance arrangements should help to ensure that these 'good characteristics' are in place.

The standards associated with the NAPF's Pension Quality Mark identify a series of issues that should be reviewed as part of these governance arrangements, and this process should help to ensure that suppliers are kept under pressure to provide the characteristics discussed above. These issues for regular review include:

- The effectiveness, accuracy and cost of the administration (whether in-house, third party or by a pension provider), including internal control mechanisms.
- The performance and charges of the fund managers.
- The appropriateness and range of the investment choices offered, particularly the default fund.
- The effectiveness and accuracy of member communications and information.
- The level of employee engagement, including the level of take-up and the level of employee contributions (particularly where these are voluntary or flexible).
- The adequacy of the processes and support for members approaching retirement, including take-up of the Open Market Option.
- The overall level and structure of the charges, both for current and former employees, and how well these charges are communicated to employees.
- Relevant changes to legislation, regulation or tax rules.

Q9. How can the Regulator work with the pensions sector to ensure that for members, trustees and scheme managers there is greater transparency and comparability of costs and charges?

Value for money in management charges is an essential feature of good DC provision and transparency has a key role to play in ensuring that members understand what they are being charged and the services that the charges cover.

One useful step would be for charges to be disclosed as 'Pounds and Pence' rather than in percentage form.

There is also a role for proxy measures. The NAPF's Pension Quality Mark is awarded to schemes that demonstrate high standards across a number of criteria, including contributions, governance and communications. One of the 'PQM' tests for good governance is that:

> *'Average total charges, including all administration and fund management charges that are paid by scheme members (including both current and past employees) must be not more than a 1% Annual Management Charge. The standard applies to any default fund, or limited range of risk-return rated funds that are offered as a simple choice for new members (see standard B5), or any other funds which are used by more than 20% of scheme members.'*

Members of schemes that have achieved the PQM can be confident that their schemes' charges offer good value for money.

Q10. Is there sufficient understanding of and attention to, the protection of assets, particularly among trustees?

The NAPF has not seen any evidence to indicate that there is currently a problem in relation to security of members' assets. Unless the Regulator has such evidence, it would not be appropriate for it to intervene further in this area.

In any case, the Regulator should bear in mind that it is not starting from a blank sheet of paper. The current system already provides strong protection for assets in DC pensions:

- In trust-based pensions, the trustees act on behalf of the members to ensure that members' assets are securely and responsibly invested.

- For contract-based DC schemes, the Financial Services Authority conducts prudential supervision of insurers.

- The recently introduced Solvency II regime for insurers ensures that they hold sufficient capital to meet their commitments – even in the event of a major shock to the market.

Q11. To what extent, and how, can less engaged or knowledgeable employers be helped in choosing a pension scheme which will deliver the good member outcomes identified in this document?

The answer to this challenge lies in the Super Trust model described in this response. Super Trusts would provide an easy-to-use, high-quality way of providing pensions for employers of all kinds, including those less inclined to focus on the detail of their workplace pensions.

We envisage up to 20 Super Trusts, based on sectors or regions. Employers would be able to select the Super Trust that suited their employees, so the market would benefit from the dynamics associated with choice and competition.

Super Trusts would also help to ensure that NEST – which we expect to play a very important role in the future of pension provision – provides quality services at a competitive cost.

Full details of the NAPF's vision of Super Trusts are given on pp. 20-26 above.

Q12. How much further should the Regulator, in conjunction with the pensions sector, focus on administration standards? What particular areas might complement the existing focus on record-keeping?

By its very nature, the task of running a DC scheme requires a daily focus on administration than is the case in DB. In DC, contributions have to be regularly collected and invested against each individual member's name, whereas administration activity in DB is concentrated around specific 'milestone' events, such as when a member becomes deferred or takes his pension.

This means that standards of administration tend naturally to be higher in DC than in DB, so it is understandable that the Regulator's recent campaign on administration and record-keeping has focused on the DB sector, where it perceives there to be room for improvement

As the question indicates, the Regulator is now considering new initiatives on the DC side, but we note that the consultation paper provides no analysis to justify this. In the absence of this evidence, we would suggest that there is no case for any increased regulatory focus on DC administration.

Q13. What more can be done by the Regulator, or those running schemes, to improve the outcomes for members at the decumulation stage of the pensions lifecycle?

The NAPF agrees that there is scope for making a difference at the decumulation stage. However, it is important to remember that the fundamental cause of poor outcomes is that people are not saving enough and this is the key point that must be addressed.

Although the Government's recent reforms have introduced greater flexibility – for some individuals at least – in the way in which they can convert their pension savings into income, there are still a number of problems that could be tackled.

- First, the average pot is very modest – just £26,000.[18] Although the Government's announcement of a simpler, more generous State Foundation Pension will lift many pensioners off means-tested benefits, we still need people to save more. In addition to the stronger foundation of a more generous State pension, the other key step towards this objective is to provide simpler, high-quality workplace pensions based on large scale and good governance – as set in the Super Trust model set out in this paper.

- Second, even though this is the point in the retirement saving cycle at which people are most engaged, many savers still do not take the opportunity available under the Open Market Option to shop around. Only 67 per cent of people shop around for their annuity, with 32 per cent subsequently purchasing an annuity from a provider other than the one that provides their pension.[19] Further steps should be taken to encourage shopping around. The Regulator should also consider what it can do – in conjunction with providers – to make it easier for people to move 'pots' from one provider to another, for example, when they change jobs.

- Third, the combination of increasing longevity, low interest rates and growing regulation (most recently the *Test Achats* ruling from the European Court of Justice) has depressed annuity rates. One positive step to address this problem would be to allow spouses to combine their pots to purchase a single joint-life annuity, thereby maximising their buying power and – one would expect – securing a better annuity deal. Greater issuance of index-linked, long-dated gilts would also help to boost annuity rates.

- Fourth, many people have a poor understanding of pensions – particularly in terms of investments and decumulation.[20] Schemes should put a strong emphasis on high-quality

[18] *Defined Contribution Pension Provision,* DWP, 2009
[19] *Annuity Purchasing Behaviour*, ABI research paper no.23, 2010
[20] *DC Pensions*, DWP, 2009

communications to members. The standards for the NAPF’s Pension Quality Mark provide a useful guide to what good DC communications should look like.

Q14. What changes, if any, are required to achieve clear accountabilities in DC schemes?

The starting point for this question must be a clear understanding of what the accountabilities are and of where they lie. In trust-based DC, accountability lies with the trustees, due to their fiduciary duty to act in the interests of the members.

In contract-based DC, however, many important accountabilities (eg, for decisions on employee contributions and investment) lie with the member – even though they may not be well equipped to take decisions on these matters.

Other accountabilities lie with the employer (eg, for making employer contributions) or with the provider (eg, for providing good communications and administration).

There are significant ways in which these accountabilities can be adjusted or made clearer.

- Members need help in taking the difficult decisions they face over matters such as contributions, investment and annuity choice. We are pleased to see the Regulator acknowledge this (at para.130).

- The NAPF’s prescription would be Super Trusts. Not only would they have the capacity to help and guide members through the maze of decisions they face in DC, Super Trusts would also have the scale and investment expertise to offer guarantees on annuity rates or investment . (See para.78 above.)

We referred earlier to the importance of good governance arrangements, and we repeat that message now. The NAPF’s Pension Quality Mark standards identify models for ensuring good governance in DC schemes and for ensuring that sponsors and providers are held to account. The models are:

— trust-based governance;
— a management committee; or
— an annual review.

We describe on p.28 how each of these approaches can deliver high-quality good governance.

Good *investment governance* should also be a feature of well run DC schemes, and the NAPF has been closely involved in – and supports - the work of the Investment Governance Group, including its recently revised *Principles for investment governance of work-based defined contribution pension schemes*.[21]

Q15. How can accountabilities for good member outcomes in DC provision be more clearly understood, particularly by members or employers?

Better understanding can only be achieved by better communication, from employers and providers. Again, better governance should be a key factor in generating high-quality communications.

We also need a stronger focus on financial education and information. The NAPF is playing its part through our Pensions Force initiative, which provides on-site talks on retirement saving for employees.

Q16. Are there areas of occupational DC product design and governance risk where the regulator could do more to support trustee understanding of their accountabilities?

The Trustee Toolkit already covers the key areas of trustee competence in the DC area, and the NAPF's assessment is that this works reasonably well. The NAPF also provides its own training courses and these provide a useful extra resource for trustees.

The NAPF would repeat the arguments advanced throughout this response about the benefits of scale. Fewer, larger schemes would mean there would be fewer trustees, making it easier for the Regulator to focus its efforts on further strengthening their levels of knowledge and understanding.

Q17. Are there areas of administration in work-based personal provision where the Regulator could do more to support managers' understanding of their accountabilities?

As we indicated above in answer to Question 12, the Regulator has provided no justification for further intervention in the administration of DC schemes. In fact, Question 17 appears to be seeking such justification.

[21] IGG, November 2010

As we explained under Question 12, standards of administration tend to be relatively good in DC pensions, so we see no case for further intervention unless the Regulator can justify it.