Securing the future of pensions

OFT: Defined Contribution workplace pension market study

NAPF response

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Overview

The NAPF welcomes the Office of Fair Trading's (OFT) market study of workplace defined contribution (DC) pensions.

It agrees with the OFT's assessment of some of the potential risks in the workplace DC market and is pleased to see that it reflects some of the NAPF's major long-standing concerns. The NAPF believes that governance, transparency of charges, value for money and economies of scale are critical to delivering good workplace DC pensions and that the governance gap in contract based schemes, high charges in legacy schemes, the disclosure of charges in a transparent and consistent format and the lack of scale and resource in small schemes are among the issues that need to be urgently resolved. This will ensure that pension savers, especially those that are going to be saving into a pension for the first time through automatic enrolment, benefit from these improvements from the outset.

We welcome the long-term principles set out in the OFT's report of ensuring greater flexibility, allowing for easier switching, increased economies of scale, independent governance and the alignment of incentives between all parties.

However, we believe the OFT could have gone further and that some of its short to medium term recommendations on governance and charges may fail to deliver the right outcomes for savers. Our major concerns are:

- Placing governance committees at provider level could lead to conflicts of interest.
- The resource and knowledge constraints trustees in small trust-based schemes may face.
- A ban on Active Member Discounts (AMD) could cause consumer detriment where employers have chosen to pay part of the charges for active members.
- The low barriers to entry for master trusts.

The NAPF believes that the Government and regulators need to take immediate action on these issues. The success of the OFT's short and medium term recommendations will depend on how they are implemented by the industry.

Therefore, whilst we agree with the conclusion of the study, that the Market Investigation Reference (MIR) is not necessary at this point in time, we urge the OFT to continue to monitor the workplace DC landscape.

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About the NAPF

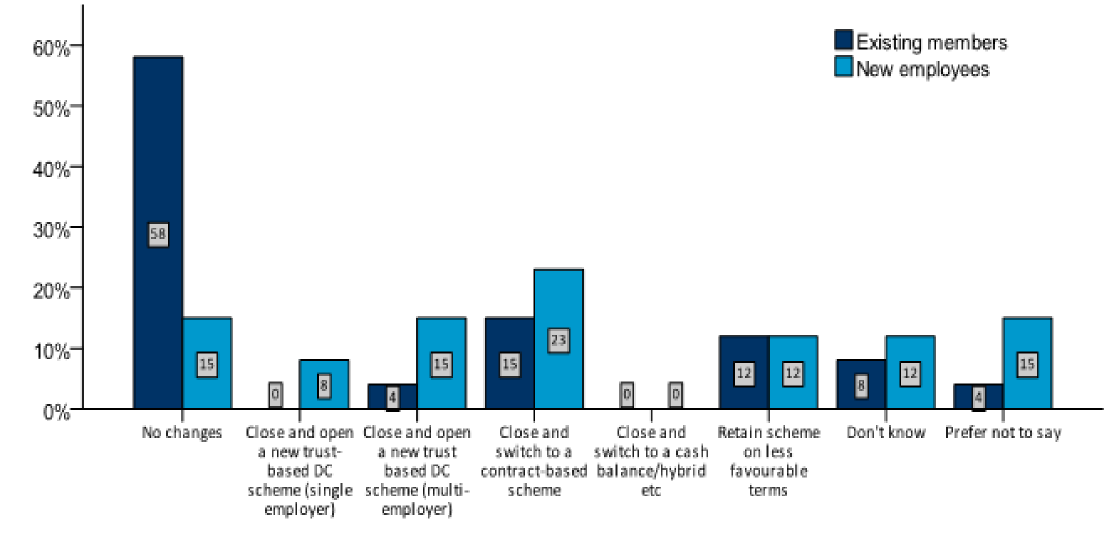
The National Association of Pension Funds (NAPF) is the leading voice of workplace pension provision in the UK. We represent some 1,300 pension schemes from all parts of the economy and 400 businesses providing essential services to the pensions industry. Ten million working people currently belong to NAPF member schemes, while around 5 million pensioners are receiving valuable retirement income from those schemes. NAPF member schemes hold assets of some £900 billion, and account for over one sixth of investment in the UK stock market. Our main objective is to ensure the security and sustainability of UK pensions.

NAPF response

1. Between 6 million and 9 million people are expected to be automatically enrolled into a workplace pension scheme by the end of 2018 as a result of the Government's reforms. Most of those people are expected to join defined contribution (DC) schemes. This follows a decline in defined benefit (DB) pensions over the last 15 years. According to the Annual Survey of Hours and Earning, 28% of employees were members of DB schemes in 2012 compared to 46% in 1997, while 17% were in a DC scheme compared to 10% in 1997.[1]

2. Only 13% of NAPF members with private sector DB schemes which responded to the NAPF's 2012 Annual Survey were open to new members. Figure 1 shows that when asked whether they expect to make changes to their DB scheme in the next five years, 1 in 5 said they will close their DB scheme to current scheme members and switch to a trust or contract based DC scheme instead. 12% expect to retain their DB scheme but on less favourable terms for existing members.[2]

Figure 1: Scheme expected changes to (fully) open private sector DB schemes



[1] 2012 Annual Survey of Hours and Earnings: Summary of Pension Results | 22 February 2013
[2] NAPF, 2012 Annual Survey. https://ols.napf.co.uk/membersarea/shop/layout6.asp?PID=262&Child=Child

3. Given the large number of people being automatically enrolled into workplace DC schemes, the NAPF welcomes the OFT market study which has looked at whether the DC arrangements currently in place offer pension savers value for money. The NAPF has conducted member surveys and held meetings to inform this study. The NAPF has been encouraged by the OFT's focus on governance, transparency of charges, the structure of charges, legacy schemes, value for money, scale and entry requirements for master trusts.

Governance

4. The NAPF believes that good governance properly aligned with members' interests leads to good pension outcomes for savers. Under automatic enrolment, employers have a duty to bring in a workplace pension scheme for eligible employees. As the OFT rightly recognises, employers are increasingly opting for contract-based DC schemes where pension providers are responsible for the delivery of pension provision for pension savers. Pension providers in this situation ultimately have a legal duty to the shareholders of their company. In comparison, where employers opt to use a trust-based DC scheme, trustees have the fiduciary duty to act in the interests of the scheme's members.

5. The NAPF therefore agrees that there is a governance gap in contract-based schemes that must be filled as soon as possible. It is not clear, however, that the Independent Governance Committees recommended by the OFT will be as well placed as trustee bodies to support pension savers. The NAPF is concerned that placing these committees at provider level could lead to conflicts of interest. Providers already have other legal duties, such as those to their shareholders, and are bound by the limitations of contract law. Pension providers will also face the expense and resource burden of putting in place Independent Governance Committees for all the different arrangements they have with each employer, which could run to the thousands.

6. The NAPF recommends that employers, as the ultimate decision makers in appointing workplace pension schemes, are given the obligation to put in place a governance arrangement to support the interests of pension savers. The NAPF-run Pension Quality Mark (PQM) recognises the important role governance plays in ensuring good outcomes for scheme members and therefore expects employers to have such governance bodies in place before being awarded the PQM. The NAPF believes that employers have the choice to put in place a Management Committee under a contract-based arrangement, run a single employer trust-based scheme, or place their employees in a master trust, where the governance is delegated to the Trustee Board of that particular master trust.

7. The NAPF is equally concerned about small trust-based schemes and the resource and knowledge constraints that trustees in such schemes may face. Furthermore, such schemes are unable to benefit from the economies of scale in the same way as larger single employer schemes or master trusts. The NAPF agrees with the OFT's recommendations that such schemes need to demonstrate the value of money they offer to savers. The Pensions Regulator (TPR), who will be responsible for developing guidelines for assessing value and setting out what action will be taken when a scheme fails such an assessment, must ensure that these complement current quality standards in DC and do not increase the burden on trustees already running good pension schemes.

8. The NAPF recommends that any standards set for trust-based schemes should apply to contract-based schemes as well. The NAPF agrees that the *Pension Charges Made Clear: Joint Industry Code of Conduct* should be the standard to build upon in assessing value for money. It is essential that regulators work together to ensure that the interests of pension savers are being met in all governance models.

Charges

9. Charges pay for the administration and services provided to maintain and grow pension savings. These charges have an impact on the size of a pension pot. Where charges offer value for money, they result in higher pension savings. NAPF modelling suggests that members saving in to schemes with poor governance and high charges can lose up to a quarter of their savings.[3] This is why the NAPF agrees with the OFT's assessment that charges need to be transparent, clear and comparable.

10. The NAPF led on the development of the *Pension Charges Made Clear: Joint Industry Code of Conduct* that was launched in November 2012. The Code seeks to respond to a number of concerns around transparency of charges raised by the Pensions Minister, the Work and Pensions Select Committee, the Workplace Retirement Income Commission (WRIC), TPR and now the OFT. The Code applies to anyone helping an employer with their automatic enrolment pension scheme. Industry representatives following the Code are expected to provide employers with a Summary of Charges document, an illustration of the impact of charges on an employee's pension pot and a table showing what services are paid for by these charges. The NAPF and the industry partners that developed the Code intend for the documents to be used to compare charges and the value for money that these schemes provide to members. The Code only came fully into effect on 13 September 2013, with the launch of the Association of British Insurers' (ABI) webtool and the NAPF expects to start monitoring take-up in the near future.

11. The NAPF believes the Code should be used by the Government in any mandate it issues on assessing scheme quality and in establishing comparability.

12. The OFT has also suggested, and the NAPF agrees, that the disclosure of a single charge will help employers and scheme members better understand the costs associated with their scheme and the impact of these on their pension savings. The NAPF agrees with the OFT that transaction costs are complex and may confuse pension savers, potentially deterring them from making good investment choices. The NAPF believes that the Financial Conduct Authority (FCA) and the Investment Management Association (IMA) should build on the guidance that has already been developed and seek to make these costs clearer and easily accessible.

Legacy schemes

13. The NAPF is very concerned about the level of charges in legacy schemes. The NAPF welcomes the OFT's recommendation for an audit of legacy schemes established before 2001, which are at

[3] NAPF, Response to DWP consultation on minimum quality standards, http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0333-Minimum-quality-standards-NAPF-response.aspx

risk of providing members with poor value for money, due to high and complex charges. The NAPF agrees with the OFT's recommendation for an Independent Project Board to conduct the audit of these schemes and would welcome the opportunity to participate on this Board. Powers should be awarded and legal duties for providers amended such that it is easier for savers to be switched to schemes that provide value for money when problems have been identified.

14. The NAPF believes that employers and trustees should be able to show that the charges paid out of pension savings are providing value to savers through the services and products that are being offered as a result.

15. Some schemes have two sets of charge structures - one for active members and another for those who leave their scheme. The active members receive a discount on their charge, which can sometimes be a subsidy from the employer, who is willing to cover the AMC as long as the scheme member works for them. Members who leave a scheme then see a rise in their charges, which is also referred to as a deferred member penalty.

16. The OFT has expressed concern about the higher charges taken out of the pension pots of members that have left the scheme and has recommended a ban on such charges. The NAPF, however, is concerned that a ban on Active Member Discounts (AMDs) could cause consumer detriment where employers have chosen to pay part of the charges for active members. This means that these scheme members would have to pay the full AMC, decreasing the size of their pension pot over a lifetime. The Government and regulators should instead focus on establishing the value for money assessments and comparability features that would ensure that the charges provide value for money for all members – both active and deferred.

Scale and Master Trusts

17. The NAPF has, for a number of years, called for the better use of economies of scale to deliver value for money for scheme members. In our *Fit for the future: NAPF's Vision for Pensions* report we outlined the benefits that scale offers schemes, especially workplace DC schemes. The charges associated with such schemes are generally lower – giving a saver in a large scheme potentially more in pension savings compared to those saving in smaller schemes with higher AMCs. Trustees running smaller schemes also have limited financial resources to put towards investment and financial advice, among other things. The NAPF welcomes the OFT's long term principles on ensuring that there are economies of scale. The evidence that scale delivers value for money for scheme savers is being demonstrated by many of the master trust arrangements being used by employers for automatic enrolment.

18. The NAPF is, however, concerned about the low barriers to entry for master trusts. Although HMRC has recently strengthened the scheme registration process in order to help tackle pension liberation fraud, much more needs to be done to ensure quality in workplace pension schemes. The NAPF believes that any processes and rules developed by the Government and TPR should ensure that only those who are able to offer real scale and have contingency and growth plans in place to ensure the safety of members' savings are able to set up as master trusts.

Conclusion

19. The NAPF welcomes the OFT report and agrees with its assessment of some of the potential risks in the workplace DC market. That is why the NAPF brought together the industry to develop the Code of Conduct on Charges. The NAPF has also launched the Pension Quality Mark (PQM) to recognise high quality workplace DC schemes. The Government and TPR are also pursuing a number of initiatives in this area which seek to ameliorate the issues that have been raised in the report. It is imperative that these separate initiatives complement each other and that pension schemes and employers receive clear information to better understand what is expected of them.

20. The OFT has made a number of recommendations on how the pensions industry can improve to ensure better outcomes for pension savers. The NAPF believes that the OFT could have gone further in its recommendations. We are concerned that the OFT's recommendations on governance and value for money risk falling short of delivering good outcomes for members in the short term as a number of legislative and regulatory barriers will need to be addressed first. The Government and regulators need to look at making legislative and regulatory changes to ensure that the recommendations can have the intended and necessary impact and to properly address consumer detriment in the short, medium and long term.

21. Given the work being undertaken by the pensions industry to improve outcomes for scheme savers, the NAPF does not believe that the Market Investigation Reference (MIR) is required at this point in time. The NAPF does recommend, however, that the OFT continue to monitor these developments.