NAPF

Securing the future of pensions

Better workplace pensions – Putting savers' interests first: a response by the National Association of Pension Funds

November 2014

Contents

Executive Summary

We strongly support the Government's focus on improving governance in DC pension schemes (both contract and trust-based) and on ensuring members get good value for money for the charges they pay. In our response to the previous consultation in March, NAPF welcomed this focus - but raised a number of concerns around implementation.

We are pleased that the DWP have acted on some of these concerns, however a number of issues have not been addressed. This consultation response sets out further changes and action that DWP should take to help well-run schemes and their members, and improve the implementation of the reforms:

- The regulations on **Chair's Statements** should be kept short and high level so that trustees can focus on the issues that matter to their scheme. The DWP should amend the draft regulations on Chair's Statements to make the list of items to be covered shorter and less prescriptive. The Pensions Regulator should also review its DC Code of Practice, Guidance and related materials and reduce the level of detailed prescription.
- There should be joined-up assessment of the cumulative costs of all the reforms and regulatory changes required of pension schemes, by an **Independent Pensions Commission**.
- The earlier schemes see the **final regulations** the easier it is for them reduce the costs and risks for their members of bringing in these changes. Therefore, it is essential that the Government publishes the final regulations, including the definition of what is covered by the cap, as soon as possible in the New Year.
- Reporting on compliance with the charge cap in the **2015 scheme return** leaves very little time, and will be less meaningful as it will only cover a short period rather than a full year. We therefore recommend that it would be more proportionate to only require schemes to report on compliance with the charge cap in their 2016 scheme returns.
- The DWP should amend the regulations to make their requirement for trustees to 'explain' the process they went through to assess **good value** clearer. The Pensions Regulator and FCA should work with trust and contract-based schemes to develop guidance on the kind of steps that trustees and IGCs might take to assess value.
- On **transaction costs**, the NAPF is very supportive of moves to improve disclosure. However, we are concerned about the implementation timetable and the requirement to report on transaction costs before there is agreement on a consistent framework for investment managers to provide information. The NAPF will continue to work with the DWP, FCA, IMA and ABI to agree how best to disclose transaction costs across the industry.

Implementing Better Workplace Pensions

Introduction

1. The NAPF is the voice of workplace pensions in the UK. We speak for over 1,300 pension schemes that provide pensions for over 17 million people and have more than £900 billion of assets. We also have 400 members from businesses supporting the pensions sector. We aim to help everyone get more out of their retirement savings. To do this we spread best practice among our members, challenge regulation where it adds more cost than benefit and promote policies that add value for savers.

2. We strongly support the Government's focus on improving governance in DC pension schemes (both contract and trust-based) and on ensuring members get good value for money for the charges they pay. The NAPF has led industry action to improve the quality of both trust and contract-based DC pension schemes:

    - The NAPF led work to develop *Pension Charges Made Clear: Joint industry Code of Conduct* to create consistent standards for communicating charges across the industry, to help employers pick the best scheme for their staff. The Code went live in 2013 with the launch of an online charges calculator to facilitate comparisons.
    - In 2009, NAPF launched Pension Quality Mark to improve the quality of DC schemes. The standards cover contributions, governance and communications and include a charge cap on default funds, which was reduced to 0.75% per year in February 2013.
    - In 2013, new standards for master trusts were launched by Pension Quality Mark, to ensure the trustee chair and a majority of those on trustee boards are independent, and that trustees fully control the investments used by the scheme. Seven master trusts have now gained PQM READY status. Employers offering PQM READY master trusts will automatically qualify for PQM status provided they make sufficient contributions (at least 6% of a minimum 10% overall contribution).

NAPF's response to the March consultation

3. In our response to the consultation that started in March 2014 on *Better Workplace Pensions: Further measures for savers*, NAPF welcomed the focus of the Government on scheme quality and charges, but raised a number of concerns around implementation. We are pleased that the DWP have acted on a number of the concerns we raised during the consultation, in particular:

    - The need to revise the ban on **'Active Member Discounts'** so that it stops unfair cross-subsidies, but does not stop employers from paying charges on behalf of their members, as this risks ending a valuable employee benefit.
    - Our recommendation that the required **minimum number of trustees** is reduced from seven to three, to give schemes more flexibility to focus on setting the right arrangements for their circumstances, and getting the best people as trustees.

- Our concern that the proposed 3 years **term limits for independent trustees** did not recognise the real asset that high-quality long-standing trustees can be to a scheme.
- That **trustees should be encouraged to engage with scheme members** and understand their views, but different approaches will suit different master trusts, and the DWP should not set out specific requirements about how engagement should be implemented.

4. However, a number of concerns raised by NAPF have not been addressed and this consultation response sets out further changes and action that DWP should take to improve the implementation of the reforms, and help well-run schemes manage costs and risks for their members.

Good scheme governance

5. In October 2014 NAPF published *Pension Possibilities: Making the right choices for the long term*, our manifesto for what the next Government needs to do on workplace pensions. In that we set out the case for Government to switch from regulating, prescribing and guiding the activities of trustees to regulating the trustees themselves to ensure they have the fitness, competence and expertise to run the scheme. NAPF believe that strong governance is a much more effective way of ensuring that schemes are well run than detailed regulation.

6. Judged against these criteria the thrust of the proposals on governance is very welcome, particularly the focus on ensuring trustees on master trust boards are independent and are not constrained. However, we do have concerns that the list of items to be covered by Chair's Statements is getting longer, and this risks going further into the territory of micro-managing trustees. The regulations on Chair's Statements should be kept high level so that trustees can focus on the issues that matter to their scheme. **The DWP should amend the draft regulations on Chair's Statements to make the list of items to be covered shorter and less prescriptive.**

7. These regulations on governance add to a growing plethora of regulatory material for DC trustees, including the Regulator's Code of Practice and their guidance, and the master trust assurance framework. The DC Code is 58 pages long and includes 115 uses of the phrase "Trustees should" and 34 "Trustees must". These new regulations mean these materials need to be reviewed. This review is an opportunity to start making the shift away from prescription that the NAPF calls for in *Pension Possibilities*. **The Pensions Regulator should review its DC Code of Practice, Guidance and related materials and reduce the level of detailed prescription.**

Costs and Charges

8. The introduction of the charge cap means that, for the first time, the Government is setting a maximum price for workplace pensions. This places an obligation on the Government to keep the costs of delivering workplace pensions under review, to ensure that this charge cap can be met

without schemes having to cut back on vital elements of service for members. The current intense level of reform and regulatory change being implemented by the UK government and EU is one of the major sources of cost pressures for schemes, and this looks likely to grow. The enhanced governance and reporting requirements in *Better Workplace Pensions*, the budget reforms, and the planned introduction of auto-transfers and new EU IORP directive will together add significant cost to workplace pensions, while the real-world costs of delivering automatic enrolment to small and micro employers remains to be seen.

9. In our Manifesto *Pensions Possibilities* the NAPF made the case for a joined-up assessment of the cumulative costs of all the reforms and regulatory changes required of pension schemes, and that this should be undertaken by an Independent Pensions Commission ahead of the planned 2017 review of automatic enrolment. **The Government should act now to adopt this recommendation to ensure the long-term sustainability of workplace pensions.**

Charge cap implementation and reporting timetable

10. Most DC workplace schemes already operate charges well below the charge cap. The Office of Fair Trading (OFT) found that charges had reduced from an average AMC of 0.79% in 2001 to 0.51% in 2012. The average charge in schemes who are members of the NAPF is just 0.46%. For the minority of schemes that do charge over 0.75%, making the necessary changes to investments and administration to meet the charge cap is extremely challenging in such a short timescale, and there can be higher costs and risks for members in making changes too quickly. Some of these schemes have had to already start making changes without seeing the regulations they need to comply with, which also has risks for these schemes and their members of having to make further adjustments at even greater speed. In addition, for all schemes there is the challenge of quickly implementing systems to demonstrate compliance when the DWP's new definition of charges, 'member borne deductions', is still not set in regulation.

11. The earlier schemes see the final regulations the easier it is for them reduce the costs and risks of change for their members. **Therefore, it is essential that the Government publishes the final regulations, including the definition of what is covered by the cap, as soon as possible in the New Year.**

12. Schemes will need to demonstrate compliance with the charge cap in two separate reporting cycles, through both their Chair's Statement and their Annual Scheme Return to The Pensions Regulator:

    - Chair's Statements are produced at the same time as scheme annual reports at the end of the scheme year (this is set by the scheme and often aligns with the financial or calendar year, but not always). The first Chair's Statement will not need to be produced until the first full scheme year has been completed after the changes come into effect, so will not need to be produced until after April 2016 at the earliest.

* However, DC scheme returns have to be completed every summer and the regulations suggest that scheme will have demonstrate compliance in their first scheme return in summer 2015, just a few months after the final regulations are published and not much more than a few weeks after the requirements come in.

13. Reporting through the 2015 annual return gives schemes limited time to digest the final regulations and make sure their systems are in place before declaring they are compliant through the return. The reporting will also be less meaningful as it will cover only a short period, and schemes will have to pro-rata what is supposed to be an annual charge cap. **We therefore recommend that it would be more proportionate to only require schemes to report on compliance with the charge cap in their 2016 scheme returns after a more meaningful period has passed.**

'Good value' and 'value for money'

14. Trustees of well-run DC schemes already work hard to make sure that members are getting a good deal when it comes to charges and the services they receive. The DWP's focus on value rather than just charge levels is very welcome, but this is a new way of framing trustees' responsibilities towards scheme beneficiaries. In our response to the March consultation we called for more work to be done on what is required in an assessment of 'value for money'. The wording for trust-based schemes seems to have changed to 'best value' (though the recent FCA consultation on requirements for contract-based schemes kept the 'value for money' wording).

15. Neither phrase is well-defined, and schemes remain unsure what the regulatory expectation is. This uncertainty about the interpretation of the draft regulations means schemes fear they could be open to legal challenge in the future. The requirement to 'explain' their assessment is particularly concerning as it is not clear if this means explaining their decision, or the assessment process they went through. The NAPF believes that the final regulations should make clear that this requirement is for trustees to summarise the process they went through to assess value, and that guidance should then be provided for trustees on what this process might include.

16. It is important that regulations and guidance, whilst not being prescriptive, give trustees comfort that they are meeting the requirements of the regulations, and expectations of regulators. **The DWP should amend the draft regulations to make clear that the requirement is for trustees to 'explain' the process they went through to make their assessment of value, and The Pensions Regulator and FCA should work with trust and contract-based schemes to develop guidance on the kind of steps that trustees and IGCs might take to assess value.**

Transaction costs

17. NAPF is very supportive of moves to improve disclosure of transaction costs, so that those governing schemes can have full understanding of all the investment costs being borne by members, and can seek to ensure that appropriate value is gained for any expenditure. Currently

there not enough consistency in the disclosure of transaction costs in the industry, with some aspects lacking in transparency. It is also difficult for schemes to get meaningful information – especially as information can be swamped with excessive data.

18. However, schemes and providers are concerned about the implementation timetable and the requirement to report on transaction costs before there is agreement on a consistent framework for how investment managers should be disclosing these costs. Gathering, assessing and disclosing transactions costs will add new burdens to schemes, but this information will only be beneficial to members if schemes can compare costs with expected levels, and benchmark themselves against other schemes and providers.

19. Therefore, there is a risk that schemes face a new cost burden which will be of limited benefit. The NAPF will continue to work with the DWP, FCA, IMA and ABI to agree how best to disclose transaction costs across the industry. Our expectation is that useful disclosures will need to take the form of predictions of levels of turnover and relevant transaction costs, alongside disclosed outcomes, both for the provider and for the market as a whole, and for the provider to offer brief explanations of relevant differences.

Response to specific consultation questions

Q6. Do the draft regulations meet our policy intention of ensuring that occupational schemes are well-governed?

The thrust of the proposals on governance is very welcome, particularly the focus on ensuring trustees on master trust boards are independent and are not constrained. However, we do have concerns that the list of items to be covered by Chair's Statements is getting longer, and this risks going further into the territory of micro-managing trustees. The regulations on Chair's Statements should be kept high level so that trustees can focus on the issues that matter to their scheme. The DWP should amend the draft regulations on Chairs Statements to make the list of items to be covered shorter and less prescriptive.

Q12. Do you have any comments on the policy intention of:

(a) imposing the cap on the total fund of the member and no just on contributions made after the relevant date?

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

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

With regards to (c), we are concerned that limiting the opportunity for schemes to change charging structure, reduces their flexibility to deal with new unavoidable costs. For instance, responding to a new regulatory requirement might mean that a scheme needs to introduce a flat-rate administration charge. We would prefer that schemes had more flexibility over the timing of changes to charge structures.

Q16. In addition to the questions already asked, is there anything else in the policies as set out in this paper on which you have any comments?

Do you have any comments on how the draft regulations reflect the policies explained in this paper?

We have a number of concerns on the some of the drafting in the document and regulations:

- Occasionally the paper refers to a "Trustees' Statement" as well as a "Chair's Statement" and this could cause confusion. We presume the Chair's Statement is correct.
- The requirement for the Chairman's signature on the statement (p99) could leave difficulties in a situation where the chair is temporarily not available, and there should be provision for another trustee to sign if necessary.
- The requirement for the annual statement to include transaction costs (also p99) should be caveated with the phrase "where available" to align the stated policy attention.

Q17. Is the scheme return the most proportionate way to obtain information on compliance with the governance standards and charges measures? Draft regulation 23 sets this out in more detail.

As mentioned earlier in the main response, DC scheme returns have to be completed every summer and the regulations suggest that scheme will have demonstrate compliance in their first scheme return in summer 2015, just a few months after the final regulations are published and not much more than a few weeks after the requirements come in.

Reporting through the 2015 annual return gives schemes limited time to digest the final regulations and make sure their systems are in place before declaring they are compliant through the return. The reporting will also be less meaningful as it will cover only a short period, and schemes will have to pro-rata what is supposed to be an annual charge cap. The NAPF therefore recommends that it would be more proportionate to only require schemes to report on compliance with the charge cap in their 2016 scheme returns after a more meaningful period has passed.

Q18. Is the proposed compliance approach to the Chair's Statement, as described in draft regulations 24 and 26 appropriate and proportionate?

In terms of timing we are happy with the approach so long as the first Chair's Statement will not need to be produced until the first full scheme year has been completed after the changes come into effect, so will not need to be produced until after April 2016 at the earliest.

As mentioned in response to question 6 and earlier in the main response, we are concerned that the list of items to be covered by Chair's Statements is getting longer, and this risks going further into the territory of micro-managing trustees

Further information

For further information please contact:
Richard Wilson
Policy Lead: Defined Contribution Pensions
richard.wilson@napf.co.uk
020 7601 1724