

Enabling good member outcomes in work-based pension provision

This paper sets out our response to the feedback we have received to our DC discussion paper, 'Enabling good member outcomes in work-based pension provision'.

The Pensions
Regulator

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A reminder of the key points in the discussion paper

The discussion paper

Our discussion paper, **'Enabling good member outcomes in work-based pension provision'**, was designed to open up a dialogue with the pensions industry about our approach to regulating defined contribution (DC) schemes. It set out the reasons for our review and identified 6 key elements that we believe are necessary to achieve a good member outcome from a DC pension.

We presented a segmentation of the market, which enabled us to more effectively analyse the risks to members' benefits. We also presented an analysis of the segments and identified areas where the market is working well and those where it works less well.

We set out our view that a market works well for customers where the supply and demand sides of the market are in balance. This means that employers and members are able to influence the provision they receive, while at the same time providers deliver DC products with the interests of members at their heart. This situation encourages the supply of quality products at competitive prices by durable providers. We highlighted some of the differences in the regulatory framework for products in the DC market, and questioned the extent to which these differences are important. We also asked how well these differences are appreciated and understood by the decision-makers in DC schemes.

Finally, we set out the 9 key areas which we feel pose the greatest challenges to members achieving a good outcome.

The responses

We received 60 responses to our discussion paper. These represented opinions both from the supply and demand side of the market. Responses were received from providers, trustees, administrators, trade and industry groups, consumer representative bodies and some individuals.

We wish to thank all those who responded and feel that this has been a very positive and helpful exercise. As expected, with a paper which covered such a wide variety of topics and raised issues that affect so many organisations and individuals, views in some areas were more polarised and representative of specific interests.

Our detailed conclusions and further analysis will be issued in the autumn of 2011. This response provides a high-level summary and our initial thoughts on the key issues that were raised.

6 key elements of a good member outcome

There was strong consensus that we have correctly identified the key elements that enable a member to achieve a good outcome from their DC pension. Respondents did, however, note that each must be underpinned by strong governance and clear communications.

Some respondents felt that the elements should be weighted or prioritised in some way. Our view is that each is necessary and that no element is of higher priority than any other.

We propose to use the 6 elements as a basis for assessing the quality of a DC scheme, and we expect these elements to be key considerations for anyone offering a DC pension scheme.

Segmentation

There was strong consensus that we have presented a sensible segmentation of the market. Some respondents believe that the segmentation could be broken down further, eg that schemes with 10,000 or more members could form their own segment; that the small schemes segment could be separated out further; and that a scheme with up to 1,000 members is too large to be described as a small scheme.

We noted in the paper that our segmentation was intentionally broad and we recognise the market is more dynamic and intricate than portrayed. We do not propose to present the segments in any new way as we believe the current model is sufficient for its intended purpose. As discussed below, very small member-directed schemes may warrant a different regulatory approach.

Regulatory framework

Most respondents said that they understand the regulatory differences in the DC landscape and the implications these have on providers and their products. This, however, was not always reflected in the answers given to some of the additional questions, eg around the protection of assets. Many of the responses said that the member and employer do not need to know or understand the regulatory differences as they take advice and their advisers do know the differences. Where employers do seek advice, a number of respondents said that advice should be regulated, as this is a gap in regulation that will take on increasing significance when the automatic enrolment duties require employers to select a suitable pension scheme.

The regulator will continue to work with HM Treasury, the Financial Services Authority (FSA) and the Department for Work and Pensions (DWP) to ensure that DC provision remains safe and durable, with equivalent safeguards where appropriate and limited opportunity for regulatory arbitrage. The DWP has recently held a call for evidence on regulatory differences in the pensions landscape. We will work with the DWP in the lead up to their publication in the autumn of a full set of proposals on how certain differences will be addressed.

9 key challenges

Small schemes

This is an area where some respondents felt there should be greater granularity within the segmentation.

There are some small schemes that deliver good value to their members and are well governed. However, our regulatory experience tells us that many small schemes face challenges in these areas and are less likely to enable members to achieve a good outcome from their savings. This can be as a result of being on a legacy platform or that they cannot benefit from economies of scale.

A number of respondents told us that The Pensions Regulator ('the regulator') should not interfere in this market, and that existing market forces will encourage members into the most effectively run schemes. A number of trade bodies, however, responded that there should be a consolidation or migration of small schemes into larger, better run schemes, and that regulatory intervention is needed for this to happen in a way that protects members.

The issues raised by trade bodies reflect the regulator's concern that the industry may not yet be ready to deal voluntarily with the risk that many small schemes pose to members. The high number of small schemes (schemes with fewer than 1,000 members account for 25% of occupational scheme memberships) suggests the market may tend towards maintaining the status quo. The length of time taken for schemes to wind-up is further indication that the market may not yet be voluntarily managing risk to members of some small schemes. As automatic enrolment may bring new employers and members into small scheme provision, the regulator remains concerned that good member outcomes will not be achieved from this form of provision.

We will hold further discussions with the DWP and key industry stakeholders about the issue of small schemes and what steps should be taken both to reduce risk to members in poorly run small schemes, and to impress upon employers the importance of selecting an appropriate scheme to fulfil their automatic enrolment duties.

Multi-employer schemes with non-associated employers

These types of arrangement are viewed by many respondents as a good alternative to small scheme provision. While many respondents supported the regulator's assessment of this segment, a number also felt that the regulator has been too negative and that the benefits gained from the schemes outweigh the concerns.

This range of views appears to support the regulator's perspective that while these schemes have the potential to be a force for good, particularly through economies of scale and strong governance, there remain some issues that are worth further exploration and discussion. This is particularly the case given the likelihood that these will be used as vehicles for automatic enrolment.

We will continue to gather intelligence on the current models and structures in this market, and to track developments as pensions reform takes effect. We will also look at where it may be sensible to strengthen both safeguards and governance standards within these arrangements, and the most appropriate ways of doing that. In particular, we initially expect to focus on the management of potential conflicts of interest between the trustee and the provider.

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Product characteristics

The regulator wants products used for automatic enrolment to be fit-for-purpose. We are keen to avoid the DC products designed today becoming the poor value legacy products of tomorrow. This means they should be strongly governed, easily understood by the membership and deliver value for money.

We asked whether, to help achieve this, baseline standards should be set for core product features. The consensus from the responses was that product characteristics are important, and that already a core set is emerging – the level of contributions, default fund, member communication and member understanding, retirement processes and value for money being the most popular.

The possibility of setting baseline standards for core features drew mixed responses. Some respondents said that the regulator should not attempt to define standards because the market already works; whilst others suggested a kite-marking or accreditation scheme. A number suggested that only more regulation will ensure that providers deliver better product features for members.

The FSA recently published a response to their consultation, **Pension reform – Conduct of business changes**, which aligned their conduct of business rules with the legislation implementing the pension reforms. The response confirmed that they also expect providers to design and deliver schemes which are suited to their membership.

The DWP has also recently published default guidance setting out industry standards for governance of funds, charging structure and communications.

As part of our operational processes, we will continue to discuss this important issue with key stakeholders, in particular how the industry might embrace a voluntary accreditation or kite-marking initiative for schemes used as vehicles for automatic enrolment. We believe this could greatly improve confidence in work-place pension provision and provide a strong platform upon which increased contributions can be encouraged where appropriate. As part of this discussion we will provide more detail on what we believe good DC provision looks like.

Costs and fair value

Charges are a key issue of consumer interest and high or unpredictable charges can negatively impact overall confidence in savings products.

There was overwhelming consensus that costs should be clear, simple and comparable.

We would like to see all pension schemes and service providers focusing more closely on the value they offer to employers and ultimately individual members. This includes increasing awareness of the impact of charges through the disclosure of fees and costs in a clear, transparent and comparable way. This will better enable key decision-makers to appreciate value for money and to make judgements about the quality of the products and services they are buying.

There is a clear opportunity here for the industry to voluntarily provide a template that can be used across all DC provision to enable better comparability of value for money.

The DWP has a reserve power to legislate in relation to charges in schemes used for automatic enrolment if there is evidence of unacceptable charges being levied in schemes.

We will gather information on emerging industry practice in this area and will work with government and the industry to consider potential refinements to the ways costs and charges are disclosed.

Protection of Assets

Over half of the respondents who answered this question agreed that there is insufficient understanding of and attention given to the protection of assets in DC arrangements. A strong divide emerged on this issue between those respondents who felt that the assets are best protected through prudential standards and those who felt that assets are best protected through the fiduciary duty of a trustee.

The protection of assets, and understanding of it, is fundamental to any successful long-term saving vehicle. With this in mind we believe there is a need to raise awareness amongst employers, trustees and pension scheme managers about the protection of DC assets, particularly where the existing safeguards, protections and compensation arrangements are unclear or spread across regulatory regimes. We will also better target our approach by considering those risks which relate to prudential matters separately from those which relate to conduct of business.

It is likely that we will seek to establish an early warning system to alert us to potential issues in this area. We will look more closely at the effectiveness of the current whistle-blowing regime, the potential role of a new DC notifiable events regime, the data that we can collect at scheme registration and through scheme returns, and how we collect intelligence both internally and from other agencies and organisations.

Selection of a suitable scheme

There was strong consensus that, to support automatic enrolment, the regulator should provide information and guidance to help employers select a suitable scheme. Some respondents highlighted the link here with product characteristics and noted that if schemes used for automatic enrolment were accredited or kite-marked in some way, this would immediately make it easier for employers.

A number of respondents believed that all employers should take advice when selecting a scheme. From our segmentation analysis we know that some employers do not, and will not, take advice when making key decisions and the regulator does not believe it should force advice upon employers. A number of other respondents also noted that, where advice to employers is sought or taken, it is not a regulated activity. They suggested that perhaps it should be.

The current requirement for employers to designate a stakeholder pension scheme continues to apply. Workplace pensions reform requirements will supersede this requirement from 2012.

The regulator will pursue the possibility of an industry accreditation or kite-marking scheme and will refer the comments regarding the regulation of advice to employers to government partners for their consideration. In addition, in the run-up to the introduction of the automatic enrolment duties, the regulator will provide more information to employers to help them make informed decisions about their automatic enrolment scheme.

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Effective and efficient administration

There was strong consensus that administration remains a very important area for the regulator. However, it was also strongly felt that we have been quite active in this area already and that we should perhaps give this work time to bed in.

Some suggestions of areas other than record-keeping that may be important for us to focus on included: making it easier for schemes to switch administrators, schemes making better use of auditors to carry out data audits, and the regulator taking action against those administrators who do not meet the standards expected of them. Some respondents thought that minimum administration standards should be a core feature of schemes used for automatic enrolment.

High quality administration is a vital component of all DC provision. We will continue to monitor the response to existing guidance and will respond appropriately to these findings. We will consider the issues surrounding the ease of switching administrator, the quality of administration for deferred members and the minimum administration standards that could apply for a voluntary accreditation or kite-marking scheme.

Decumulation

Almost every respondent commented on the importance of improving member outcomes at retirement. This reflects the already high level of interest in the industry around the retirement process. There was recognition that progress has been made in this area, and general agreement that these foundations need to be built upon to ensure that all DC members are enabled to achieve the optimal outcome at retirement.

There were many suggestions for new thinking in this area: collective drawdown, **PPF (Pension Protection Fund)** providing annuities, state-supported default, guaranteed pension bonds and relaxing the taxation rules around advice to employees. There was also acknowledgement of the changing landscape: increasing longevity; phased retirement; varying income requirements during retirement; and the end of the requirement to annuitise.

There was much comment on the need for changes to address the challenges faced by those with small pots, for example easing the trivial commutation rules so that very small annuities do not need to be set up, and making transfers more straightforward. Alternative suggestions included allowing spouses to amalgamate pots, and allowing transfers of small pots into **NEST (National Employment Savings Trust)**.

A significant number of respondents recommend that the **Open-market option (OMO)** should become the default. Many respondents also noted that the decumulation phase should not be seen as separate from the accumulation phase. Suggestions to smooth the transition between the two phases included increasing member education, especially starting education about retirement choices much earlier in the individuals' membership of the scheme.

The design of any life-styling process was also highlighted as a key factor in improving member outcome. How lifestyle works and communicating it to members are important, especially as members' situation may have changed substantially since they originally joined the scheme.

There was some strong criticism of both trustees and insurers on this issue. Some respondents stated that trustees' responsibilities extend beyond telling members about the OMO; others noted that some insurers frequently offer poor value annuities to the members who have saved with them.

The DWP will publish proposals in autumn 2011 for the management of small pots and improvement in transfer activity.

There is already much activity in this area by both industry and other government departments. With this in mind, we will share the ideas suggested by respondents with the DWP, HM Treasury and FSA and take any initiatives forward through this broader government engagement.

Clarity of Accountabilities

Many respondents agreed that accountability, especially in contract-based arrangements, is unclear and that it would be beneficial to agree and disclose accountability when the scheme is set up and throughout the life of the scheme. Some felt that the regulator should provide clarity around the legal framework of accountabilities; others believed that advice to employers should be regulated, thus making advisers accountable. The **Investment Governance Group (IGG)** template was cited several times as being a suitable tool to extend to this area. In its recently published guidance on default funds, the DWP has also urged use of the IGG template.

The regulator agrees that accountabilities for decision-making in DC schemes should be clearly disclosed and that this can help to improve governance standards. This also makes it possible for members to know who to turn to in the event of a problem.

We will consider the suggestions received and discuss with government partners and industry whether a template could be used to agree and disclose accountabilities when a scheme is set up, possibly extending the IGG template for this purpose.

Our expectations going forward

The Pensions Regulator's objectives include protecting the benefits of members of work-based pension schemes, promoting and improving understanding of good administration and maximising compliance with the new employer duties.

To this end, we aim to ensure that the schemes members join are safe, durable and fair, and that our regulatory framework is fit-for-purpose in the continuously changing landscape.

Later in the year we intend to publish a more detailed response to the feedback we have received and set out how we will update our DC regulatory approach to mitigate risks to members.

All parties in the DC landscape have a role to play in ensuring schemes deliver a good member outcome. As an indication of the direction of travel, below we outline some of our expectations as to how positive engagement on both the supply and demand side can help to improve standards.

Providers and fund managers

Providers and fund managers, we expect you to deliver high quality, safe products that deliver good value for money and enable members to achieve a good outcome from their savings.

We expect you to ensure that the schemes offered to members today do not become tomorrow's problem legacy products.

We want you to respond to the challenge of delivering an accreditation process for the products used for automatic enrolment, thus providing a more certain world for employers selecting a scheme and increasing member confidence in saving into a pension.

We want to see more transparency in the way charges are disclosed, demonstrating value for money in a clear and simple way.

We want you to offer products that can deliver a good outcome for members whether they are actively engaged in saving, or have little financial knowledge or desire to engage.

Administrators

Administrators, you must make sure that your services and systems are robust, scalable and that you meet the high standards that DC provision requires and which we hope employers and trustees will demand.

Advisers

Advisers, you will play a key role in supporting employers with their new duties, particularly in the selection of a suitable scheme. Some individuals will also look to you for advice on the scheme they are automatically enrolled into.

Both the regulator and the FSA expect the fees you charge for advice to be reasonable and firms may wish to look at the recent recommendations of the **Consultancy Charging Working Group**.

Employers

Employers, the decisions you make now will have a profound effect on your business, your staff and the pensions landscape in the long-term. You must select a pension scheme which meets the qualifying criteria for automatic enrolment, but that also meets your needs and the needs of those who will be automatically enrolled into it.

You need to give careful consideration to the financial strength of the provider, the core product characteristics and the levels of ongoing engagement you are able to provide.

You should also consider the impact on scheme members of any advice that is paid for from their funds. Where this happens, the charges should provide value for money.

Trustees

Trustees, you are accountable for your scheme delivering a good member outcome. You need to be bold in challenging your service providers to ensure that they deliver a scheme that works for you and your members.

Members

Individual savers, you will get the most out of a DC scheme – as with any financial product – if you take an active role. There is a lot of information that you can access. Look for information from **The Money Advice Service (TMAS)** and **The Pensions Advisory Service (TPAS)** and consider taking advice about the best way to achieve a good outcome from your savings.

Next steps

Later this year we intend to publish a more detailed response to our consultation. This will set out some of the steps we intend to take to mitigate the risks to members that we have highlighted in this report. It will also distinguish, where possible, between short term actions and longer term initiatives.

In the meantime, we will continue our dialogue with government partners and industry on the matters raised in our discussion paper.

List of respondents

1. Association of British Insurers
2. Association of Consulting Actuaries
3. Aegon
4. Alexander Forbes
5. Alliance Bernstein
6. AON Hewitt
7. Association of Member Nominated Trustees
8. Association of Pension Lawyers
9. AVIVA
10. B&CE
11. BBS Consultants & Actuaries
12. Blackrock
13. Buck Consultants
14. Capita Hartshead
15. Confederation of British Industry
16. Dimensional Fund Advisers
17. FairPensions
18. Federation of Small Businesses
19. Fidelity
20. Financial Reporting Council
21. First Actuarial
22. Friends Life
23. G4S
24. Heath Lambert
25. Hymans Robertson
26. Institute of Chartered Accountants in England and Wales
27. Investment Management Association
28. Institute Of Directors
29. Jaguar Land Rover
30. Jardine Lloyd Thompson
31. Legal & General (Assurance Society Limited)
32. Legal & General Investment Management
33. Lloyds Banking Group
34. Mercer
35. The Money Advice Service
36. National Employment Savings Trust (NEST)
37. National Association of Pension Funds (NAPF)
38. NAPF Pension Quality Mark
39. Pensions Management Institute (PMI)
40. Prospect Union
41. Reckitt Benckiser
42. Royal Bank of Scotland
43. Royal Mail Defined Contribution Plan
44. Royal Society of Arts
45. Skandia Life
46. Society of Pension Consultants
47. Standard Life
48. Supertrust UK
49. Tax Incentivised Savings Association
50. The Pensions Advisory Service
51. Trades Union Congress
52. UK Sustainable Investment & Finance
53. Which?
54. Xafinity

In addition to the respondents listed here, 6 individuals provided responses to the consultation, 1 of whom requested to remain anonymous:

55. Mr Mike Atkin
56. Mr Phil Derges
57. Mr Matt Fuller
58. Mr Ralph Jones
59. Mr David Kershaw
60. Anonymous

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