ASSOCIATION OF CONSULTING ACTUARIES

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pensions.investment@dwp.gov.uk

To Whom it May Concern

Improving Outcomes for Members of Defined Contribution Pension Schemes

I am writing on behalf of the Association of Consulting Actuaries in response to the above-named consultation issued by the DWP.

Our key points are:

- We support consolidation where schemes are not providing good value for members. The new requirement to assess value relative to larger schemes (where benefits could realistically be transferred) will provide a clear-sighted framework for trustee boards. However, at present, sourcing the information needed for the comparisons in a cost effective way is challenging. Measures will need to be taken to make this data available (ideally through publicly accessible information).
- Where trustees conclude that better value could be achieved through alternative arrangements, there may be conflict between trustee desire to act on this and the sponsor's objectives, resources and budgets. Guidance for trustees on how to proceed in such cases would be helpful.
- Trustees will rely heavily on investment managers and DC platform providers being able to supply information in a consistent, accurate and timely way. Engagement with the investment management industry to articulate the requirements will be essential for success.

We trust that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful. In that event, please contact me on 07557 031198 or at tessa.page@mercer.com.

Yours sincerely

Tess Page
Chair, Defined Contribution Committee
On behalf of the Association of Consulting Actuaries Limited

Encouraging Consolidation

Q1. We would welcome your views on the reporting of net returns – how many past years of net returns figures should be taken into consideration and reported on to give an effective indication of past fund performance?

We are supportive of using net returns in assessing performance and in our experience most trustee boards have used this approach for some time.

The timeframe will vary depending on the asset class and objectives of the funds under review. These typically will range from three to five years but could for example require a full market cycle of five to seven years to demonstrate whether the mandate had delivered the required long term performance.

For the growth element of a default arrangement in particular, we would encourage long term investment. Less liquid assets are now starting to be used in DC investment arrangements, and in these cases, there can be practical challenges in reporting over shorter (say one to three year) periods, due to the investment cycle of these asses (e.g. private equity, infrastructure).

Q2. Do you think that the amending regulations achieve the policy aims of encouraging smaller schemes to consolidate into larger schemes when they do not present optimal value for members?

Yes, in the main.

There will be exceptions or areas where the aims may be challenged, for example where there is no trustee or sponsor budget to carry out a bulk transfer and / or a wind up – noting that trustee boards do not often "own" the budget for such activity. Trustees would benefit from clear guidance on how to proceed if there is a conflict between the trustees' conclusions and the objectives of the sponsor.

Our other concerns in this area are:

- Unintended behavioural consequences. There is arguably an incentive to give the "benefit of the doubt" and find a way to evidence that a scheme provides value, rather than being open and honest about shortcomings. Some trustees may be reluctant to seek an adviser with a reputation for thoroughness to help them assess their value, or to really commit to broad value assessments (noting that some elements of value will always be subjective, such as the quality of communications, scheme governance, etc, which many trustee boards include in their assessments).
- Additional Voluntary Contribution arrangements (where not held in a scheme's "main" DC Section) will not be scrutinised. Our view is that these arrangements often provide poor value, with high legacy charges, poor transparency and appalling service standards.
- October 2021 is an ambitious deadline if schemes are to be thorough in their process.
- The comparison of net returns against three comparison schemes as required in the draft legislation would potentially be a problem for some schemes (depending on the timing of their end of scheme year) because of the lack of published information on net returns in the first year of the new requirements and the availability of quotations, particularly if the

scheme is not a compelling prospect for bidders (for example, if the scheme is closed, small, and / or has low contribution flows / high member turnover).

- The proposals will focus attention on the obvious "measurables" of performance and price. Non-financial factors, and aspects of value that cannot be easily measured, can be just as important and it would be helpful to make clear these issues should be considered. For example, the quality of investments on a forward-looking basis, the range of options available to members, and scheme governance.

Q3. Do you believe that the statutory guidance increases clarity about the minimum expectations on assessing and reporting on value for members for specified schemes? Are there any areas where further clarity might be required?

The guidance seems reasonable and comprehensive. Our suggestions for further clarity are:

- Coverage of the past performance – we think it would be helpful if the guidance explicitly said that no reporting is required for any funds in which there are no longer member assets. As an example of unintended consequences of not specifying this, we note that auditors checking Chair's Statements often request data and cost projections for funds which are no longer used, on the basis they were shown in the previous year's accounts. This does not add value to the process.
- Engagement with the investment management industry will be important to ensure that they are able to provide the data as set out in the regulations, within the appropriate timeframes.
- Comparators – it is not clear how trustees will be able to identify these comparator schemes. Trustees should have reason to believe that at least one of them would accept the scheme should it decide to wind up and consolidate, and our expectation is that the comparator schemes will generally be master trusts or other consolidators. If so, central publication of data for these schemes would be welcome. If costs cannot be easily provided publically given the need to reflect scheme-specific circumstances, then master trusts and consolidators could be asked to publish a range of generic examples for different scheme sizes / metrics.
- Measurement for member transactions – we do not believe that SLAs are necessarily a good measure of quality. Some are quite stringent and others very easy to achieve, and they do not focus on the member experience (net promoter scores or similar could be used here).
- Valuing guarantees – guarantees (a feature of primarily legacy arrangements), such as those embedded in with profits funds, are hard to value, and the details available from providers of such arrangements are often opaque. It is also hard for trustees to assess whether members value such benefits. This will add complexity and cost and may be a barrier to schemes with larger with profits exposures consolidating. We strongly support greater pressure on providers to supply basic information on costs, market value adjustments, underlying investment experience and guarantee terms.

Diversification, performance fees and the default fund charge cap

Q4. Do the draft regulations achieve the policy intent of providing an easement from the prorating requirement for performance fees calculated each time the value of the asset is calculated?

Yes.

Q5. What should we consider to ensure a multi-year approach to calculating performance fees works in practice?

The operational requirements will largely be for investment managers to implement, who will have to provide regular information on the level of performance fees being applied within the fund. We therefore believe that investment managers of these products would be better placed to provide detail on how a multi-year approach would work in practice.

Q6. We are proposing a five-year rolling period. Is this appropriate or would another duration be more helpful?

See our comments under question 1.

Q7. We are proposing offering a multi-year option as an alternative to an in-year option for schemes. Do you have any suggestions for how to improve this offer?

Our only comment on this question is that where possible the guidance to trustees should be kept simple, with step-by-step guides or process flowcharts available to work through the mechanics. This is particularly relevant for smaller schemes who may not have the resources for adviser support.

Q8. To what extent will providing a multi-year smoothing option give DC trustees more confidence to invest in less liquid assets such as venture capital? Do you agree with our proposed guidance that fully complying with the charge cap does not necessarily indicate value for money?

The barriers to investing in less liquid assets for DC scheme trustees have, to date, not been the implementation or monitoring of performance fee structures. Rather, the lack of confidence stems from:

- Practicalities around managing the illiquidity, and the extent of work required with the administrator, platform provider (if relevant) and other parties to implement a fund.
- Understanding what would happen in the event of fund gating.
- Availability of suitable vehicles in which to invest (particularly for schemes on platforms), which have a total cost (whether performance related or not) that trustees assess to be good value for the benefits provided.
- Difficulties of blending such a strategy with other, more liquid, funds in blended funds.
- Mixed evidence in relation to the risk-adjusted returns available from such investments.
- Variable knowledge levels on trustee boards, combined with a governance budget (in terms of both time and financial resources) that is already stretched thinly.

The multi-year smoothing option certainly helps with one potential barrier, but will not solve the broader challenges associated with investment in less liquid assets.

Q9. Do the draft regulations achieve the policy intent? Do you have any comment on the definitions used?

Yes, no further comments.

Updates to Statutory Guidance: Reporting costs, charges and other information

Q10. Do you believe that the updated statutory guidance increases clarity about the minimum expectations on both the production and publication of costs and charges information? Are there any areas where further clarity might be required?

Yes, we believe that the proposals increase clarity and raise the bar for expectations in this area.

Gathering the necessary data can be time consuming, and some investment providers do not report to the required level of detail and timeliness. Further, reporting is provided in different formats, despite initiatives to gain consistency.

The template for investment manager data needs to be set out, and must be relevant for both DB and DC schemes. It would not be helpful, in our view, for DB and DC schemes to be required to report using different frameworks, particularly given the number of hybrid schemes.

It would be beneficial to clearly state that Chair Statements may be published excluding the signature of the Chair, for data protection reasons, as different parties have had different interpretations in this regard.

Other changes to legislation

Q11. We propose that where the default arrangement includes a promise, the trustees of the scheme should be required to produce a default SIP. We propose that this should be produced within 3 months of the end of the first scheme year to end after the coming into force date.

(a) Do you agree with this policy?

(b) Do you agree that the legislation achieves the policy??

a) Yes.

b) Draft regulation 4(2) amends the definition of “default arrangement” in the 2005 Investment Regulations so that, for its purposes, Regulation 3 (6), (7) and (8) of the Charges and Governance Regulations 2015 apply. The intention is to bring with-profits funds within the scope to produce a default SIP. These arrangements with a third party pension promise are covered under (6)(a), and are brought into scope as intended. However, the amendment will also bring into scope, under (6)(b) – an arrangement that “provides no benefits other than benefits which are attributable to additional voluntary contributions”, which we do not believe to be in line with the policy intent.

Q12. We are proposing that, for relevant schemes, charges and transaction costs should be disclosed for any fund which members are (or were) able to select and in which assets relating to members are invested during the scheme year.

(a) Do you agree with this policy?

(b) Do you agree that the legislation achieves the policy?

a) Yes.

b) It may be helpful to clarify the meaning of “assets related to members **are invested**”. Our reading is that the intent is to capture any assets held in a fund during the period, but it could be interpreted to mean "new contributions" i.e. "making investments" (this would then exclude deferred member benefits, for example).

Q13. Do you agree with this proposed change? Do you have any other comments on this topic??

We agree the proposed change to exempt wholly-insured schemes from the asset manager policies required in Statements of Investment Principles. We also note the following:

i. Implementation statements for wholly-insured schemes

We have seen conflicting interpretations of what a wholly-insured scheme is required to disclose in its annual report, and on a publicly accessible website, in respect of voting behaviour, stewardship, engagement activities, asset manager policies, and related matters. These schemes are not required to have the associated policies in their SIPs. However, the Disclosure of Information Regulations 2013 does not include equivalent exemptions. The disclosure requirements are slightly different for relevant and non-relevant schemes but both flow from Regulations 12 and 29 with Schedule 3 paragraph 30. Some clients are exempt from having the SIP policies but they have been told they must report on the closely associated matters in their implementation statements. This can lead them to "tick box" disclosures such as wholly-insured schemes describing their non-existent voting behaviour or asset manager policies when in practice due to their insured nature, they have no control over the asset manager policies.

ii. Default SIPs for wholly-insured schemes

There is also some confusion around default arrangement SIPs for wholly-insured schemes.

It is not clear whether the insured schemes exemption also applies to default SIPs or not. Regulation 8 (Modification of regulation 2 in respect of wholly-insured schemes) of the Investment Regulations 2005 modifies Regulation 2 (Statement of investment principles) where a scheme meets the wholly-insured criteria. However, Regulation 2A (Additional requirements in relation to default arrangement) leverages policies in Regulation 2. It is not clear whether Regulation 8 feeds through to Regulation 2A.

If the wholly-insured scheme exemptions apply also to the default SIP requirements then it would be clearer if Regulation 2A and/or Regulation 8 explicitly cross-referenced one another.

On the other hand, if the default SIP requirements apply in full to wholly-insured schemes, then it would also be useful to state that within the regulations. If this is the intention, we do question whether it makes policy sense to require a wholly-insured scheme to have policies specifically for its default arrangement, when it is accepted that those policies are not relevant or are disproportionate for a (whole scheme) SIP.

Appendix: Legal disclaimer

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